United States Court of Appeals

for the Second Circuit

EXHIBITS

74-1244 B

P/5

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ANTOINETTE M. BRAGALINI, ARNOLD DAMSKY, WILLIAM WEINSTOCK, CARL ROGERS and ROSE ROGERS, H. L. FEDERMAN & CO., INC., SUZANNE MASTERS, STEPHEN MASTERS and NORMAN KEMPER, individually, and as Stockholders of MASTERS, INC., suing in behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs-Appellants,

-against-

LOUIS BIBLOWITZ, MAX BIBLOWIT, JOSHUA BIBLOWITZ, RALPH J. WEINER, JOEL BIBLOWITZ, ARNOLD GINSBURG, HERBERT ABRAMSON, HARRY GRUNTHER, HARRY L. LEWIS, PINCUS PETERSEIL and MASTERS, INC.,

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

APPENDIX - VOLUME II (EXHIBITS)

LEVENTRITT LEWITTES & BENDER
Attorneys for Plaintiffs-Appellants
405 Lexington Avenue
New York, N.Y. 10017

Tel. 986-4080

TABLE OF CONTENTS

Page No.

73A PG 73 ii
12/30/70 NJ

PX 1

October 31, 1966

Confidential memorandum for distribution
to the directors of Masters, Inc.

PROPOSAL OF PLAN OF MERGER BETWEEN
LADY ROSE STORES, INC. AND MASTERS, INC.

This memorandum discusses the principal aspects of a proposed plan of merger to be submitted for your approval.

This plan of statutory merger between Lady Rose Stores, Inc. and Masters, Inc. is intended to qualify as a tax-free exchange within the meaning of Sec. 368(a) (1) (A) of The Internal Revenue Code of 1954. The plan is subject to a favorable ruling to be obtained from the Internal Revenue Service.

Further, the adoption of the plan is subject to the affirmative votes of   of the Masters shareholders and 66 2/3% of the Lady Rose shareholders.

Because of certain tax benefits discussed more fully below, Masters, Inc. is the acquiring corporation and survives the merger.

Under the plan, the shareholders of Lady Rose will acquire 1,750,000 shares of $1 par value common stock and 1,750 shares of $1,000 par value 5% non-voting preferred stock. The 5% preferred stock will be converted into 1,750,000 shares of $1 par value common shares after January 31, 1972.

The 9% subordinated notes issued by Masters, Inc. in the amount of $283,000 will be converted into Masters, Inc. $1 par value common stock at $1.7143 per share.

The respective equities of the shareholders of Lady Rose Stores, Inc. and other Masters, Inc. shareholders are reflected below:

74A

		Total equities	Equity Lady Rose shareholders	Equity Masters shareholders
Masters, Inc. shares presently outstanding	(A)	453,532	69,628.5	383,903.5
Conversion of $283,000 9% subordinated notes @ $1.7143 per share		165,083	46,667	118,416
		618,615	116,295.5	502,319.5
Issuance of 3,500,000 shares of Masters to Lady Rose shareholders (after effect of conversion of 5% preferred stock into $1 par value common stock) and elimination of prior equity of Lady Rose		(116,295.5)	(116,295.5)	-
		3,500,000	3,500,000	
To be outstanding	(B)	4,002,319.5	(B) 3,500,000	502,319.5
Ratios		100.00%	87.45%	12.55%

(A) After redemption on 9/3/66 of 51,868 shares at $2.00 per share from the former president of Masters.

(B) The plan contemplates a minimum 20% equity in the $1 par value common stock of the minority shareholders until January 31, 1972.

Accordingly, the 1,750,000 shares $1 par value stock to be issued to Lady Rose effects a 77.70% voting ratio prior to conversion of the 1750 shares of the $1,000 par value 5% preferred stock.

The plan has been drafted to qualify the carry-forward loss of Masters of approximately $3,378,849 as a net operating loss deduction against the future earnings of the merged companies.

The carry-forward losses and their years of expiration are shown below:

Year of operating loss	Carry-forward loss		Date of expiration
4/30/63	$ 274,045		1/31/68
5/2/64	2,200,423		1/31/69
5/1/65	32,304		1/31/70
1/31/66	72,077		1/31/71
1/31/67	800,000	(estimated)	1/31/72
	$3,378,849		

An important tax aspect of this plan is the availability of the carry-over loss without the reduction described in Sec. 382(b) because the stockholders of Masters, Inc. (the loss corporation) retain at least 20% of the stock of the acquiring corporation. Under the law, (Sec. 382(b) a reduction in the carry-forward loss of 5% is required for each 1% of equity below 20% not retained by the stockholders of the loss corporation in the surviving corporation. (Example - if the loss corporation stockholders retain only 10% in the merged company, then only 50% of the loss carry-over is available).

The proposed plan is based on the following financial data.

		Lady Rose Stores, Inc. and subsidiaries		Masters, Inc.
Net worth - 8/31/66 and 7/30/66		$2,532,206	(a)	$1,677,438
9% subordinated loan		$ -		$ 283,000
Net income (loss) fiscal years ended 1/31/67 and 2/28/67 estimated		$ 600,000		$ (800,000)
Shares outstanding	(b)	300 1,000,000	(a)	453,532

(a) After redemption of 51,868 shares on 9/3/66 at $2 per share

(b) Capital shares used for purposes of computation of equities

Book value per share	(b)	$2.53		$3.70
Estimated earnings per share	(b)	$ .60		None
Valuation for exchange offering	(1)	$6,000,000	(2)	$ 777,490
Valuation per share	(b)	$6.00		$1.7143

(1) (10 x estimated earnings)

(2) $1.7143 per share

LADY ROSE STORES, INC. AND MASTERS, INC.

PRO FORMA BALANCE SHEET

	Lady Rose Stores Inc. and subsidiaries August 31, 1966	Masters, Inc. July 30, 1966	Pro forma adjustments (Dr.) Cr.		Pro forma balance sheet
Cash					
Merchandise inventories	$1,195,713	$ 880,428	(1)	103,736	$1,972,405
Other current assets	2,255,024	2,487,737			4,742,761
	120,770	1,162,288			1,283,058
	3,571,507	4,530,453			7,998,224
Less Current liabilities	1,750,431	2,673,858			4,424,289
Working capital	1,821,076	1,856,595			3,573,935
Investment in Masters, Inc.	160,000	-	(4) (3)	80,000 80,000	-
Property accounts (net)	372,365	408,512			780,877
Other assets	178,765	93,764			272,529
Long-term debt	-	(577,697)	(3)	(283,000)	(294,697)
	$2,532,206	$1,781,174			$4,332,644
Shareholders' equity					
Capital stock, $1 par value - Common	$ 30,000	$ 505,400	(1) (2) (2) (2) (3)	(51,868) 1,750,000 (30,000) (69,628) 118,416	$2,252,320
5% preferred stock - $1,000 par value			(2)	1,750,000	1,750,000
Capital surplus	190,075	695,170	(1) (2) (3) (4)	(51,868) (837,961) 84,584 (80,000)	-
Retained earnings	2,312,131	580,604	(2)	(2,562,411)	330,324
	$2,532,206	$1,781,174			$4,332,644

(1) Redemption of 51,868 shares on 9/3/66 at $2 per share.
(2) Exchange of Lady Rose shares for Masters.
(3) Conversion of subordinated loan.
(4) Elimination of Lady Rose investment in Masters.

LADY ROSE STORES, INC. AND MASTERS, INC.

SUMMARY OF EARNINGS

Lady Rose Stores, Inc. and subsidiaries

		Fiscal year ended				Six months ended	
		February 28, 1963	February 29, 1964	February 29, 1965	February 29, 1966	August 31, 1966	August 31, 1965
Sales	(A)	$7,380,944.47	$8,176,994.8[illegible]	$11,194,079.84	$13,124,670.43	$6,766,101.74	$5,854,592.27
Pretax income		360,753.94	304,397.77	426,262.54	679,977.03	483,991.10	234,201.44
Federal income tax		131,500.00	99,000.00	125,000.00	228,000.00	152,500.00	67,500.00
Net income		229,253.94	205,397.77	301,262.54	451,977.03	331,491.10	166,701.44

(A) First year of consolidation of equities

Masters, Inc.

	Fiscal year ended				Twelve months ended	Three months ended	
	April 30, 1962	April 30, 1963	May 2, 1964	May 1, 1965	January 29, 1966 (B)	July 31, 1966 (B)	July 31, 1965
Sales	$30,521,874	$25,065,325	$18,228,237	$21,330,206	$21,393,483	$5,336,065	$4,795,865
Concessionaire income	601,766	753,142	846,700	1,025,254	1,076,085	242,461	183,951
Pretax income (loss)	(116,642)	(1,048,902)	(52,588)	79,212	(259,737)	(45,424)	(189,642)
Federal income tax (refund)	(31,000)	68,024	-	-	-	-	-
Net income (loss)	(85,642)	(980,878)	(52,588)	79,212	(259,737)	(45,424)	(189,642)
Special items	82,325	(1,370,465)	2,819,312	-	-	(561,367)	-
Net income and special items	(3,317)	(2,351,343)	2,766,724	79,212	(259,737)	(606,791)	(189,642)

(B) Masters, Inc. changed its fiscal year to end as of January 31, 1966 (9 months period). Operations for the six months ended July 31, 1966 resulted in a net loss for that period of $794,815 after charging $561,367 as a loss attributable to the closing of the Miami stores.

asters Valuation = 770,000 7/31/66

453,500 @ 1.71 per share

Lady Rose valuation 6,000,000

1,000,000 shares

Estimated earnings 2/28/67 600,000

OUTSTANDING

$283,000 Debentures 9%

(my convertible it

Net Worth 2/28/67

Lady Rose

2,800,000 1,677,000

TOTAL shares OUTSTANDING 4,000,000

79 A

Px 2

MASTERS, INC.

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

December 22, 1966

To the Common Stockholders of Masters, Inc.:

In accordance with the By-Laws of the Company, notice is hereby given that a Special Meeting of the stockholders will be held in the Binnacle Room, Hotel Commodore, Lexington Avenue and East 42nd Street, New York, New York, at 10.30 A. M., on January 26, 1967 for the following purposes:

1. To consider and vote upon the adoption of the proposed Plan and Agreement of Merger, providing for the merger of Lady Rose Stores, Inc., a New York corporation, into Masters, Inc., a copy of which Plan and Agreement of Merger, together with the amended and restated Articles of Incorporation of Masters, Inc., constituting a part thereof, is annexed as Exhibit A to the proxy statement accompanying this notice.

2. To consider and vote upon the proposal, subject to the adoption and approval of the Plan and Agreement of Merger, to amend Masters' Certificate of Incorporation to increase the capital stock of Masters' Inc. to $7,500,000. to consist of five (5) million shares of common stock, of the par value of $1.00 and two thousand five hundred (2500) shares of 5% non-cumulative, convertible, preferred stock of the par value of One Thousand ($1000.00) Dollars each.

3. Such other business which may properly come before the meeting.

Only stockholders of record at the close of business on November 30, 1966 are entitled to notice of and to vote at the special meetings. Transfer books of Masters, Inc. will not be closed.

The Special Meeting may be adjourned from time to time without further notice than by announcement at the meeting, or any adjournments thereof, and any business for which notice of the meeting is hereby given may be transacted at such adjourned meeting.

By order of the Board of Directors.

Kenneth Kopelson,
Secretary.

IT IS IMPORTANT THAT YOUR STOCK BE REPRESENTED AT THE MEETING REGARDLESS OF THE NUMBER OF SHARES YOU MAY HOLD. IF YOU ARE UNABLE TO BE PRESENT IN PERSON, PLEASE FILL IN, SIGN AND RETURN THE ENCLOSED PROXY PROMPTLY. A RETURN ENVELOPE IS ENCLOSED FOR YOUR CONVENIENCE WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES.

MASTERS, INC.

135-21 38th Avenue

Flushing 54, N. Y.

December 15, 1966

TO THE STOCKHOLDERS:

Your Board of Directors has approved a merger agreement whereby LADY ROSE STORES, INC. will be merged into and acquired by MASTERS, INC. Your Directors recommend your approval of this merger as being in the best interests of the stockholders of MASTERS, INC.

This merger requires approval by the holders of two-thirds of the stock of both Companies. The attached Proxy Statement sets forth the material information concerning LADY ROSE STORES, INC. and MASTERS, INC., your Company. It contains the terms of the merger and other pertinent information I urge you to read it carefully.

Your Directors believe that this merger will provide MASTERS, INC. with skills, resources, credit standing and facilities which will enable your Company to take a stronger competitive position in the discount store field.

Your Directors believe that the terms of the merger are fair and equitable. Under the merger agreement, all of the issued and outstanding stock of LADY ROSE will be acquired by your Company in exchange for the issuance of 1,750,000 shares of the $1.00 par value common stock and 1,750 shares of a new [illegible] non-cumulative preferred stock, par value $1,000., which preferred stock must be converted on February 1, 1973 into 1,750,000 shares of the $1.00 par value common stock. No cash will be paid by your Company to the holders of LADY ROSE stock for the acquisition of their shares.

The present Board of Directors shall remain as directors following the merger and shall continue to serve until the next annual meeting of the shareholders.

Your Directors therefore submit this proposed merger for your consideration. If you are unable to attend the Stockholders Meeting on January 26th, 1967, please sign and return the enclosed Proxy so that your shares will be represented at that Special Meeting.

Very truly yours,

LOUIS BIBLOWITZ
Chairman of the Board of Directors

81 A

MASTERS, INC.

PROXY STATEMENT

SPECIAL MEETING OF STOCKHOLDERS

INTRODUCTION

The accompanying Proxy is solicited by the Management of Masters, Inc. (herein sometimes called "Masters," and sometimes the "Company") for use at a Special Meeting of Stockholders to be held on January 26, 1967, and any adjournments thereof, notice of which is attached hereto, to act upon a proposed Plan and Agreement of Merger (the "Agreement") with Lady Rose Stores, Inc. (herein sometimes called "Lady Rose") a copy of which is attached hereto as Exhibit A, and in connection therewith, to consider and take action on related matters specified in the notice of meeting. The Agreement provides that, upon its becoming effective, the separate existence of Lady Rose will cease and it will be merged into Masters (sometimes referred to herein as the "Surviving Corporation"), which will survive the merger and will succeed to all the rights and property and will be subject to all the debts, liabilities and duties of Lady Rose.

REASONS FOR MERGER

The reasons for the proposed merger and the benefits which are expected to accrue to Masters as a result of the merger are set forth in the Chairman's letter to stockholders which is being sent to stockholders with this proxy statement.

The terms of the merger were arrived at as a result of negotiation between the respective managements of Masters and Lady Rose and were based upon a number of factors, among them the comparative book values of the shares of the two companies, the record of their earnings, their present financial conditions, and their future prospects.

REVOCABILITY OF PROXY

Any Proxy delivered pursuant to this solicitation is revocable at any time prior to the exercise thereof and the person executing same, if in attendance at the meeting, may vote in person instead of by Proxy. All validly executed Proxies received in time for the meeting will be voted in accordance with the authority contained therein.

VOTING SECURITIES

The Company has presently outstanding and entitled to vote 460,732 shares of common stock (not including 44,668 shares of common stock held or controlled by the Company). This is the only class of stock entitled to vote at the meeting and each share of stock is entitled to one vote. Only stockholders of record at the close of business on November 30, 1966 will be entitled to vote.

SOLICITATION OF PROXIES

Proxies will be solicited hereunder primarily by use of the mails but also by direct telephone communications to stockholders by the Officers, Directors and regular employees of the Company.

CAPITALIZATION AND TERMS OF MERGER

On November 30, 1966 Masters had issued and outstanding 460,732 shares of common stock, par value $1.00 per share (excluding 35,557 shares of common stock represented by a voting trust certificate in the name of Masters and 9,111 shares owned beneficially by Masters, although owned of record by Jack Haizen, and deposited with the Creditors Committee under the Plan of Arrangement) the only class of stock presently authorized. The common stock of Masters is vested with all voting rights in the election of directors, and with all other voting rights and each share is entitled to one vote. The holders of the common stock have no-preemptive rights or conversion rights, and in the event of dissolution or liquidation, voluntary or involuntary, they will share ratably in the assets of Masters. On the same date Lady Rose had authorized, issued and outstanding 300 shares of no-par value common stock.

Upon the Merger becoming effective the authorized capital stock of the Surviving Corporation will consist of 5,000,000 shares of common stock, par value $1.00 per share and 2,500 shares of 5% non-cumulative, convertible preferred stock of the par value of $1,000 each (sometimes referred to herein as the "Preferred Stock"). The terms of each of the above classes of stock are summarized herein under the caption "Amended and Restated Articles of Incorporation of Masters, Inc."

Each share of Masters issued and outstanding when the Merger becomes effective will be converted into one share of common stock of the Surviving Corporation. Such conversion will not, however, have the effect of changing the terms of the common stock of Masters and new certificates will be issued in exchange for presently outstanding certificates representing common stock of Masters presently issued and outstanding.

In exchange for the 300 shares of no-par value common stock of Lady Rose, outstanding when the Merger becomes effective, there will be issued, ratably, an aggregate of 1,750,000 shares of the common stock and 1,750 shares of the new 5% non-cumulative preferred stock, par value $1,000. of the Surviving Corporation.

AMENDED AND RESTATED ARTICLES OF INCORPORATION AND CAPITAL STOCK OF SURVIVING CORPORATION

The Agreement provides that Masters' Articles of Incorporation, as amended and restated in Exhibit I (attached to the Agreement) will constitute the Articles of Incorporation of the Surviving Corporation. Masters' authorized capital stock now consists of 1,500,000 shares of common stock, par value of $1.00 per share. The characteristics of Masters common stock will not be changed by the amended and restated Articles of Incorporation. The 5% non-cumulative Convertible Preferred Stock of the Surviving Corporation will constitute a new class of capital stock. The following is a brief description of the provisions applicable to each class of stock of the Surviving Corporation. A complete statement of the provisions applicable to each class of stock of the Surviving Corporation is set forth in the amended and restated Articles of Incorporation, set forth as an exhibit to the Agreement to which reference should be made.

Voting Rights. The common stock has exclusive voting rights for the election of directors and all other matters except as otherwise provided by law, each share being entitled to one vote.

Conversion Rights. The preferred stock on February 1, 1973 must by its terms be converted into common stock of the Surviving Corporation at the rate of 1,000 shares of common stock for each share of preferred stock.

Dividends. The terms of the preferred stock call for non-cumulative dividends at the rate of 5% per annum before any dividends may be paid to the holders of the common stock. The common stock is entitled to dividends out of funds legally available for the purpose, as and when declared by the Board of Directors, subject to the prior right of dividends payable to the preferred stockholders as above stated.

Liquidation Rights. In the event of any liquidation or dissolution of the Surviving Corporation all of the net assets of the Surviving Corporation will be distributed to both the preferred stockholders and the holders of the common stock in the following manner. Each share of preferred stock (provided the event of either liquidation or dissolution occurs prior to February 1, 1973) issued and outstanding shall entitle the holder thereof to receive such portion of the net assets available for distribution as would be received by a holder of 1,000 shares of the common stock.

Miscellaneous. The common stock and the preferred stock carry no preemptive rights and are fully paid and non-assessable.

BUSINESS OF THE COMPANY

The business of the Company is the operation of discount stores located in the Metropolitan New York area. The stores sell a wide variety of merchandise including major appliances such as refrigerators, freezers, television sets, radios, phonographs, houseware, luggage, cosmetics, toiletries, gift ware, cameras and photographic supplies and equipment, and other merchandise. In addition, leased departments in the Company's stores sell ladies', girls' and children's wear, jewelry, men's and boys' wear, shoes, books and stationery. Arrangements with leased departments generally provide for fixed minimum rentals subject to adjustments based upon percentages of gross sales. During the thirty-nine week period ending January 29, 1966 rentals paid to the Company by the leased departments averaged approximately 10% of the sales of such departments. Such sales approximated 26% of total Masters' sales, including leased department sales for such period.

The Company purchases the merchandise sold by it principally from wholesale distributors, but also, to a limited extent directly from manufacturers thereof. On occasion the Company makes volume purchases of certain seasonal appliances and other items at substantial savings. It is the policy of the Company to purchase only current types and models of merchandise.

The Company has a substantial advertising budget of which more than 80% is spent on newspaper advertising. Leased departments contribute to advertising expenditures. The business of the Company, like that of comparable discount and other department stores is seasonal to the extent that the largest sales volume occurs during the Christmas season.

Stores and Other Property

The Company presently operates 4 stores all of which are located in leased premises. All of the stores are fully air conditioned and sprinklered.

The Company's Manhattan store is located at 62 and 66 West 48th Street, New York, N. Y. occupying a total area of 22,913 square feet consisting of the basement, main floor, mezzanine and second floor of a multi-story building in the Rockefeller Center area These premises are rented from a non-affiliated landlord, unled a lease which expires on April 30, 1972. Parking facilities are available for patrons of this store, in the numerous public garages located throughout the area.

The Company's Elmsford store, located on Route 9A in Westchester County, occupies 59,650 square feet in a one-story and basement building. Parking facilities for 1,000 cars are available. The lease on these premises expires on October 20, 1973. The owners of said premises are Harry L. Lewis and Mildred Lewis, his wife. Mr. Lewis is a director and stockholder of Masters (see "Directors and Management").

The Company's Lake Success store is located in a one-story and basement building in New Hyde Park, N. Y. Here the Company occupies 54,300 square feet under a lease (from a non-affiliated landlord) expiring February 28, 1974. Parking facilities for 1,500 cars are available for the customers of Masters.

The Company's Flushing store, located at 37-02 Main Street, Flushing, New York, is in a high density area. The premises occupied by this store consist of a three-story building, including basement and mezzanine. Parking facilities for 135 cars are available. The Company occupies these premises under a lease from a non-affiliated company expiring on January 29, 1977. The principal (executive) offices of the Company occupy approximately 10,000 feet in a four-story building which adjoins the Flushing store.

DIRECTORS AND MANAGEMENT

It is contemplated that the present employees and management of the Constituent Corporations will continue to have the same responsibilities and perform the same services in the employ of the Surviving Corporation. The business of Lady Rose may be operated as a separate division of the Surviving Corporation although no final determination as to such operation has been made. It is intended, however, that all subsidiaries of LADY ROSE (see Schedule on Page 11) will be liquidated and dissolved as part of this plan, and the business thereof will be continued by Masters.

When the Merger becomes effective, the Board of Directors of Masters will constitute the Board of Directors of the Surviving Corporation. Such directors will hold office until the next annual meeting of stockholders.

Present Directors and Officers of Masters	Shares of Masters Owned Beneficially
LOUIS BIBLOWITZ, Chairman of Board of Directors	(1) (a)
MAX BIBLOWITZ, Director	(1) (a)
JOSHUA BIBLOWITZ, Director	(1) (a)
RALPH J. WEINER, Director	(1) (a)
ARNOLD GINSBURG, Director	6,527 21/27ths (a) (b)
HERBERT ABRAMSON, Director	26,111 3/27ths (a) (b)
HARRY GRUNTHER, Director	(2) (a)
HARRY L. LEWIS, Director	6,527 21/27ths (a) (b)
PINCUS PETERSEIL, Director	6009 (3)
HERBERT KURTZ, Director	26,111 3/27ths (a) (b)
KENNETH KOPELSON, Secretary-Treasurer	(4) (a)
	9,708 (5) (a)

(a) These shares are represented by a voting trust certificate for an equal number of shares of Masters owned beneficially by the Stockholder and of record by The Voting Trustees, under a Voting Trust Agreement dated April 11, 1963. It is anticipated that the said Voting Trust Agreement will be terminated when the proposed merger becomes effective.

(b) The below listed directors of Masters are participants in the amount indicated in a subordinated loan made to Masters, pursuant to a Plan of Arrangement dated July 29, 1963, aggregating $283,000:

HARRY GRUNTHER	$ 7,500
RALPH J. WEINER	$ 7,500
ARNOLD GINSBURG	$30,000
PINCUS PETERSEIL	$30,000

(1) Lady Rose Stores, Inc., a New York corporation of which Louis Biblowitz, Max Biblowitz and Joshua Biblowitz, are officers, directors and principal stockholders is the owner of Voting Trust Certificates representing 69,629-17/27th shares of Masters. Additionally, Lady Rose Stores, Inc. is a participant to the extent of $80,000. in a subordinated loan of $283,000 made pursuant to the Plan of Arrangement dated July 29, 1963.

(2) Herbert Abramson is the President of Samuel Scheller & Co., Inc., a New York corporation, which corporation is the owner of Voting Trust Certificates representing 21,759-[illegible]/27th shares of Masters. Additionally said corporation is a participant to the extent of $25,000. in a subordinated loan of $283,000 made pursuant to the Plan of Arrangement dated July 29, 1963. Samuel Scheller & Co., Inc. is a licensed insurance brokerage firm which handles the insurance fo Masters and Lady Rose.

(3) Harry L. Lewis and Mildred Lewis, his wife, are the owners of the land and buildings in Elmsford, New York presently tenanted by Masters. (See: Business of Masters.) Mr. Lewis is a participant to the extent of $5,000 in a subordinated loan in the sum of $283,000 made to Masters pursuant to the Plan of Arrangement dated July 29, 1963.

(4) Herbert Kurtz, is Vice-President of Rockower Bros., Inc., a Pennsylvania corporation. I. Bud Rockower and members of his family are the controlling stockholders of Rockower Bros., Inc. whose wholly owned subsidiaries are operators of leased departments in Masters' stores. I. Budd Rockower and members of his family are controlling stockholders of BAC Discount Stores, Inc. which is the owner of Voting Trust Certificates representing 26,111 3/27th shares of Masters, and is a participant to the extent of $30,000 in the subordinated loan of $283,000 made to Masters pursuant to the Plan of Arrangement dated July 29, 1963.

(5) Mrs. Ida Kopelson, wife of the Secretary-Treasurer of Masters, is the owner of 5,157 shares of capital stock of Masters.

OTHER MATTERS RELATING TO THE MERGER

Background and History of the Company

Masters was initially organized in early 1937 by Philip Masters as an individual proprietorship. This business was transferred to the Company upon its organization in November, 1937 and was conducted from premises at West 48th Street in New York City. This was the Company's only outlet at the time of its founder's death in August, 1950.

The Company continued in business under the guidance of other members of the Masters family. With the fiscal year beginning May 1, 1956, the Company initiated an expansion program. It opened a store in York, Pa., a store located in Elmsford, Westchester County, N. Y. and a store located on Route 4 in Paramus, N. J. In the fall of 1957 the Company opened a large discount center in Lake Success, L. I., N. Y. In February of 1959, the Company opened a store in Flushing, N. Y. and in October of 1959 opened a store in Lancaster, Pa. In May 1960, the Company opened an outlet in Ft. Lauderdale, Florida, and in October of that year a discount center in Hempstead, L. I. The Company also constructed a warehouse in Syosset, N. Y. of approximately 100,000 sq. ft. which was then sold subject to a leaseback in favor of Masters.

The Company competes with other discount operators and operators of department stores on an established policy consisting of low-marked prices on a self-service cash basis. In addition, leased departments and concessions exist in many of the stores which departments accounted for approximately 20 to 25% of the Company's total sales.

Until April, 1963 the management of the Company resided in the family of Philip Masters, the founder of the Company

During the early part of the fiscal year ending April 30, 1963, Masters found itself in financial difficulties and on January 31, 1963 the then management of Masters, Inc. filed a petition for arrangement pursuant to Chapter XI of the Bankruptcy Laws of the United States. Thereafter, a group of concessionaires and licensed department operators entered into an arrangement with the then controlling stockholders of Masters, Inc. and purchased from said stockholders a majority of the then issued and outstanding capital stock of Masters. The new management group entered into extensive discussions and negotiations with the Creditor's Committee leading to the Plan of Arrangement a copy of which is annexed to this proxy statement. Pursuant to said negotiations the sum of $283,000 was advanced by way of a subordinated convertible loan to Masters (see: "Subordinated Loan pursuant to Plan of Arrangement").

To consolidate the operations of the Company many of the leases held by Masters at the time of the filing of the Bankruptcy petition were disaffirmed in the Court proceedings leaving the Company with 5 locations; 4 of the locations are described under "Stores and Other Property", herein, and the fifth location was in Central Plaza, Miami, Florida. In 1964 with the approval of the Creditor's Committee, the Company opened 2 additional stores, one (North Store) located in North Miami, Florida consisting of approximately 100,000 sq. ft. and the other (South Store) located in South Miami, Florida, consisting of approximately 100,000 sq. ft. In July, 1966, with the approval of the Creditor's Committee, all three Miami stores were sold to Zayre Corp., or its wholly owned subsidiaries.

Outstanding Options

As of November 30, 1966, there was an outstanding option owned by Kenneth Kopelson, Secretary of Masters, to purchase 3,600 shares of common stock of Masters at a price of ten cents per share and an exercised option to purchase 7,200 shares of Masters common stock at a price of ten cents per share, owned by Jack Haizen, former President of Masters (see "Transactions with a Former Officer"). The

outstanding option to purchase common stock of Masters will constitute an option to purchase an equal number of shares of common stock of the Surviving Corporation upon the same terms and conditions applicable thereto immediately prior to the effective date of the merger.

Vote Required and Effectiveness of the Merger

The Agreement of Merger will be submitted to the stockholders of Masters and Lady Rose, for their approval, at meetings called for that purpose. Adoption of the Agreement by Masters requires the affirmative vote of the holders of at least two-thirds of the outstanding shares of the common stock of Masters. Each outstanding share entitles the holder thereof to one vote for or against the proposed Merger.

If the Agreement of Merger is approved, it will, subject to the right of abandonment (described below), become effective on January 28, 1967, the end of Master's current fiscal year.

Rights of Dissenting Stockholders

Section 910 and Section 806 (under certain conditions) of the New York Business Corporation Law, copies of which are annexed as Exhibit B to this proxy statement set forth the right of shareholders to receive payment for their shares upon merger, consolidation or sale, lease, exchange or other disposition of assets. The nature and procedural steps involved to assert a right to obtain payment of the fair value of shares (but only with respect to shares which have not been voted in favor of the merger) are governed by Section 623 of the New York Business Corporation Law.

In the opinion of counsel for Masters, a stockholder of Masters who votes against or who by direction in a proxy votes against the adoption of the Agreement of Merger *will not* have any right to receive payment of the fair value of their shares of the common stock of Masters.

Transactions with a Former Officer

On September 6, 1966, Masters entered into an agreement with its then president who was in the process of leaving the Company pursuant to which Masters purchased from said officer a total of 44,668 shares of the Company's common stock, par value $1.00 per share at a price of $2.00 per share. Of such total, 35,557 shares were deposited under the voting trust agreement dated April 11, 1963, and 9,111 shares were deposited with the Creditor's Committee under the plan of arrangement.

In addition, on the same day, the Company entered into an agreement with said officer with relation to 7,200 shares of the common capital stock of Masters subject to option owned and exercised by said officer. Under said agreement the Company has an option to purchase said 7,200 shares during a period from June 4, 1967 to June 30, 1967, at a price of $2.00 per share. In the event the Company does not exercise the option during said period, the former officer has the right to compel the Company to purchase said shares at any time during the month of July 1967 at a price of $2.25 per share.

Masters also entered into an agreement with said officer as to severance pay and as to his continued service as an advisor and consultant. As severance pay and for such services, said officer is to be paid $45,000, payable as follows: $22,500 on January 2, 1967 $11,250 on January 2, 1968 and $11,250 on January 2, 1969.

Abandonment of the Merger

The Merger Agreement may be abandoned, whether before or after the approval of the stockholders of Lady Rose and Masters, in the event that either:

1. A ruling or rulings satisfactory to the Constituent Corporations has not been received as to the non-taxability of the contemplated transactions and as to the availability of the carry forward loss of Masters to the Surviving Corporation; or

2. The Constituent Corporations have not performed all of their obligations and complied with all of the covenants required to be performed under the agreement of merger; or

3. There has not been received the timely written approval of the Creditor's Committee in arrangement proceedings entitled

"IN THE MATTER OF MASTERS, INC., ETC."

No. 63B96 in the United States District Court for the Southern District of New York as provided for in a plan of arrangement confirmed and approved by the Court on December 27, 1963.

Plan of Arrangement

On January 31, 1963, Masters, Inc. filed a proceeding in the United States District Court for the Southern District of New York, No. 63B96 for a Plan of Arrangement pursuant to the bankruptcy laws of the United States. On July 29, 1963, the new management of Masters submitted the Plan of Arrangement to the creditors of said Corporation. This plan was adopted and confirmed by the Court December 27, 1963. A copy of said Plan of Arrangement is annexed to this proxy statement as Exhibit C and reference is made thereto as to all of the terms and conditions thereof. The Company has not defaulted in any of the terms and conditions of the plan, and is current as to all payments required to be made thereunder.

Voting Trust Agreement

On April 11, 1963 various stockholders of Masters, Inc. entered into a voting trust agreement pursuant to the Stock Corporation Law of the State of New York. All other stockholders of Masters at that time were invited to join and become part of said voting trust agreement. More than a majority of the issued outstanding capital stock of Masters has become part of this voting trust agreement. A copy of the voting trust agreement is annexed to this proxy statement as Exhibit D and reference to said Exhibit should be made as to all of the terms and conditions contained therein. It is anticipated that upon the effectiveness of the merger, the voting trust agreement, provided that the consents of all of the parties thereto are obtained, will be terminated.

Interests of Directors and Officers and Their Associates in the Proposed Merger

Louis Biblowitz, Chairman of the Board of Directors of Masters, Inc., Max Biblowitz and Joshua Biblowitz, directors of Masters, Inc. are stockholders, directors and the controlling persons of Lady Rose Stores, Inc. (See "Lady Rose Stores, Inc." herein) and are the persons who presented the Agreement of Merger to the Board of Directors of Masters for its consideration. In addition, said three individuals are Voting Trustees under a Voting Trust Agreement among stockholders of Masters. Said Voting Trust Agreement controls a majority of the issued and outstanding capital stock of Masters. (See "Directors and Management" herein and accompanying footnotes thereto for further particulars as to other relationships with Masters of certain directors of Masters.) Lady Rose Stores, Inc. operates ladies' soft goods leased concessions in Masters' stores, through corporate subsidiaries. (See "Lady Rose Stores, Inc." herein.)

Lady Rose Stores, Inc. is the owner of 69,629 $^{17}/_{27}$ shares of the 460,732 outstanding stock of Masters (all of these shares are represented by Voting Trust Certificates) (excluding shares of Masters held in the treasury of Masters as those represented by Voting Trust Certificates owned by Masters). Upon the effectiveness of the merger these shares, as represented by Voting Trust Certificates, will become treasury shares of Masters.

Subordinated Loan Pursuant to Plan of Arrangement

On or about December 27, 1963, pursuant to the Plan of Arrangement with Creditors a subordinated loan in the sum of $283,000 was made to Masters, by affiliated and non-affiliated persons, including certain concessionaires. Said loan provides for interest at the rate of 9% per annum, of which 6% shall be paid semi-annually on June 30th and December 31st, and 3% per annum accrued until after all payments have been made pursuant to the Plan of Arrangement and then paid at such time and in such manner as the Board of Directors of Masters shall determine, but in no event later than December 27, 1969, the maturity date of said loan. The Company has the right after December 27, 1968 to prepay the principal of the loan and any accrued interest.

The subordinated loan further provides that the lenders have the right to purchase shares of common stock of Masters as follows:

(i) Three shares of the common stock of Masters, par value, $1.00 per share, for every one dollar of loan extended at a price of $1.25 per share if purchased on or before December 27, 1966;

(ii) Three shares of the common stock of Masters, par value, $1.00 per share, for every one dollar of loan extended at a price of $2.00 per share if purchased on or before December 27, 1968;

(iii) Upon the exercise of the option, such portion of the sums loaned, together with accrued interest as is required, may be applied to any sums due the Company by reason of the exercise of said option.

The holders of the subordinated loan shall be requested to relinquish their options to subscribe to the common stock of the Surviving Corporation. If any such holder shall decline to so do, the options shall continue in accordance with their terms.

As of the date hereof, Lady Rose Stores, Inc. is the owner of 69,629 17/27th shares of Masters stock (represented by Voting Trust Certificates) and a participant, to the extent of $80,000., in the above referred to Subordinated Loan. (See: Footnotes to "Directors and Management" herein.) Upon the merger becoming effective said Lady Rose subordinated loan participation in the sum of $80,000. shall be deemed fully paid (thereby reducing the balance of said loan to the sum of $203,000.) and the shares of stock of Masters owned by Lady Rose (69,629 17/27th shares) would become treasury stock of Masters. The participation in the subordinated loan and the stock ownership of Masters by Lady Rose represents an investment in the sum of $160,000.

Tax Effects of the Merger

Independent tax counsel has been retained by the constituent corporations for the purpose of securing from Internal Revenue Service a written ruling confirming counsel's opinion that the tax consequences of the proposed merger, based upon the facts and circumstances detailed in this proxy statement, will be as follows:

1. The merger constitutes a "reorganization" within the meaning of Section 368(a) (1) (A) of the Internal Revenue Code (I.R.C.).

2. Valid business reasons for the merger exist from the viewpoint of each constituent corporation. Although tax benefits are expected to result, the anticipation of such benefits does not constitute the principle purpose for the merger.

3. Pursuant to I.R.C. Section 354(a) (1), no taxable gain or loss will be recognized by any stockholder of either constituent corporation by reason of the exchange of stock in either constituent corporation for newly-issued stock in the surviving corporation, pursuant to the plan of reorganization (merger).

4. Pursuant to I.R.C. Section 361(a), neither of the constituent corporations shall have recognized gain or loss as a result of the reorganization (merger).

5. Pursuant to I.R.C. Section 358(a), the aggregate basis of newly-issued shares of the surviving corporation received by a stockholder in exchange for stock or securities (in either or both constituent corporations) surrendered, pursuant to the plan of reorganization (merger), shall be the same as such shareholder's aggregate basis in the stock or securities being surrendered. To determine the basis of each share of newly-issued stock, the total number of shares received pursuant to the plan is to be divided into the aggregate basis at which the former stock and securities were held.

6. Pursuant to I.R.C. Section 362, all assets owned by the surviving corporation as a result of the reorganization (merger) shall have the same tax basis as would have been the case had the merger not taken place.

7. Pursuant to I.R.C. Section 381(a) (2) and (c) (1), operating losses incurred by Masters in prior years may be carried over by the surviving corporation as an offset to possible future income.

8. Neither I.R.C. Section 382(a) nor 382(b), purporting to deny net operating loss carryovers in certain situations applies here. Section 382(a) does not apply because, although certain changes in the ownership of Masters stock have taken place in recent years, Masters has continued to carry on substantially the same business as that conducted before such changes in ownership. Section 382(b) does not apply because the persons who owned Masters stock prior to the merger will continue to have ownership of a sufficient amount of stock in the surviving corporation following the merger.

9. I.R.C. Section 269 will not apply to disallow the operating loss carryovers otherwise available since, as stated in Paragraph 2, above, tax avoidance motives do not constitute the principle purpose for the merger. While it is understood that Internal Revenue Service will not include in a written ruling views as to the applicability or non-applicability of Section 269, the written opinion of counsel as to the non-applicability of such section has been obtained.

LADY ROSE STORES, INC.

LADY ROSE STORES, INC. ("LADY ROSE") was incorporated under the laws of the State of New York in December, 1960, and has operated under that name ever since. LADY ROSE is engaged in the sale, at the retail level, of ladies' soft goods and apparel items. Its business is conducted through its wholly owned subsidiaries, which operate leased departments at twenty-one (21) locations, located principally in and around the Metropolitan New York area (see table following for exact location of each and every leased department). All of the subsidiaries are located in neighborhood or down town shopping areas, and/or suburban shopping centers.

Competition. LADY ROSE's business is highly competitive in view of the fact that many other stores sell comparable merchandise. Many of such competitors are substantially larger in terms of size, gross sales, and working capital.

Properties. LADY ROSE's leased departments are operated under leases that vary substantially in the terms thereof. A detailed description of each and every lease including the name of the operating subsidiary, the location of the leased premises, the date of the commencement of the lease, the date of the termination of the lease, annual rental, number of square feet leased and renewal provisions is set forth below. The Company's executive offices, warehouse, central buying office and central distribution point are located at 2400 Marcus Avenue, New Hyde Park, Long Island, New York, in approximately 2[illegible],000 square feet of leased space. The lease on these premises is for a term of 10 years and the annual rental is $22,000.

All purchases for sale in each of the leased departments operated by LADY ROSE are made through its central buying office and shipped through its company operated warehouse.

Employees. LADY ROSE employs approximately 275 full-time, year-round employees. Of said 275 employees, 75% are members of various Unions, which bargain collectively on behalf of these employees. The following is a list of various Unions, representing the said 75% of LADY ROSE employees:

Local 340A	Amalgamated Clothing Workers of America
Local 883	Retail Clerks Industrial Association
Local 169	Retail Clerks Industrial Association
Local 222	International Production, Service and Sales Employees Union

In addition to the aforesaid full-time employees, at various busy seasons throughout the year, it is the policy of LADY ROSE to hire additional part-time employees. During the heaviest sales periods, up to 300 additional employees may be hired.

Management. Each of the company's leased departments takes the form of a subsidiary corporation, all of the stock of which is owned by LADY ROSE. All of the issued and outstanding stock of LADY ROSE is owned as follows:

Stockholder	Number of Shares
Louis Biblowitz	90
Joshua Biblowitz	90
Max Biblowit	90
Joel Biblowitz	30

Each of the above Stockholders, with the exception of Joel Biblowitz, is currently a member of the Board of Directors of Lady Rose and as a group constitute all of the members of the Board of Directors of Lady Rose.

The Officers of Lady Rose are as follows:

President—Louis Biblowitz

Vice-President—Max Biblowit

Secretary-Treasurer—Joshua Biblowitz

The Messrs. Biblowitz are the operational and executive heads of Lady Rose and each of its operating wholly owned subsidiaries and in such capacities devote full time to the day to day conduct of the company's business.

Legal Proceedings. There are no material legal proceedings pending against Lady Rose or any of its subsidiaries.

Operating Subsidiary	Location of Leased Premises	Date of Commencement of Lease	Date of Termination of Lease	Renewal Provisions	Annual Rental	Number of Square Feet Leased
Lady Rose of Flatbush, Inc.	2418 Church Avenue, Brooklyn. N. Y.	November, 1962	January, 1971	None	7% of Gross Sales or $24,000 whichever is greater	4,000
Lady Rose of New Jersey, Inc.	218-220 Main Street, Paterson, N. J. 92 Ellison Street, Paterson, N. J.	January, 1955	January, 1976	None	$19,000	2,500
Lady Rose of Elizabeth, Inc.	Elizabeth, New Jersey	September, 1956	April, 1972	None	$22,000	3,000
Lady Rose of Brooklyn, Inc.	Brooklyn, New York	September, 1961	August, 1967	None	7% of Gross Sales	6,000
Lady Rose of Bronx, Ltd.	37-02 Main Street, Flushing, N. Y.	October, 1961	January, 1967	None	8½% of sales in excess of $474,117, Plus $40,300	9,000
Biblowitz & Sons, Inc.	Route 9A, Elmsford, N. Y.	October, 1961	January, 1967	None	8½% of sales $474,117, Plus $40,300	7,000
Selwell Shoe Co. Inc.	Lake Success Shopping Center, Lake Success, N. Y.	October, 1957	January, 1967	None	7¾% of Gross Sales, Plus $32,500	6,500
Lady Rose Whites, Inc.	5500 Sunrise H'way, Massapequa, N. Y.	August, 1963	July, 1968	None	$32,000 Plus 8% of gross sales in excess of $400,000	8,000

Lady Rose of Middle Island, Inc.	Middle Country Rd., Middle Island, N. Y.	August, 1965	July, 1975	None	$67,350 or 8% of gross sales in excess of $841,575	13,470
Lady Rose of Lawrence, Inc.	605 Rockaway Turnpike, Lawrence, N. Y.	September, 1966	January, 1972	None	7% of Gross Sales	7,800
Lady Rose of Bayamon, Inc.	Bayamon, Puerto Rico	October, 1966	January, 1972	None	7% of Gross Sales	5,000
Lady Rose of Carolina, Inc.	Carolina, Puerto Rico	October, 1966	January, 1972	None	7% of Gross Sales	5,000
Lady Rose of Brooklyn, Inc.	Smithtown, New York	January, 1960	January, 1970	5 Years	8% of Gross Sales	12,000
Lady Rose of Babylon, Inc.	Babylon, New York	December, 1961	December, 1971	5 Years	8% of Gross Sales	12,000
Lady Rose of Sayville, Inc.	Sayville, New York	December, 1962	December, 1967	5 Years	8% of Gross Sales	13,000
Lady Rose of Port Jefferson, Inc.	Port Jefferson, New York	November, 196[illegible]	November, 1970	5 Years	8% of Gross Sales	13,000
Lady Rose of Riverhead, Inc.	Riverhead, New York	June, 1966	June, 1971	5 Years	8% of Gross Sales	13,000
Lady Rose of Levittown, Inc.	Levittown, New York	December, 1963	January, 1971	None	6½% of Gross Sales	10,660
Lady Rose Linden, Inc.	2750 Linden B'lvd., Brooklyn, N. Y.	November, 1964	January, 1971	None	6½% of Gross Sales	11,400
Lady Rose of Montauk, Inc.	Babylon, New York	October, 1965	January, 1972	None	6½% of Gross Sales	10,600
Lady Rose, Incorporated	Jamaica, New York	August, 1945	July, 1972	None	$15,000	2,500

INDEX TO FINANCIAL STATEMENTS

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF MASTERS, INC.:

We have examined the financial statements of MASTERS, INC. and the related statements of income, included elsewhere herein, for the period from May 3, 1964 to January 29, 1966. We have also examined the consolidated financial statements of MASTERS, INC. and subsidiary and the related consolidated statement of income included elsewhere herein for the year ended May 2, 1964. Our examination of the aforementioned statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned statements present fairly the financial position of MASTERS, INC. at January 29, 1966, and the results of its operations for the period from May 1, 1963 to January 29, 1966 in conformity with generally accepted accounting principles which have been applied on a consistent basis.

New York, N. Y.,
May 5, 1966.

KALISH, RUBINROIT & CO.

50 Bway
425 6500

MASTERS, INC.

STATEMENTS OF INCOME

The following statements of income of Masters, Inc. have been examined by the independent certi: public accountants whose reports thereon may be found elsewhere in this Proxy Statement. Relative to unaudited periods, in the opinion of the Company, all adjustments, consisting only of the norr recurring accruals, necessary for a fair statement of the results for the unaudited periods have b. made. The statements of income should be read in conjunction with the other financial stateme. and the accompanying notes appearing elsewhere in this Proxy Statement. The statements of inco: for the three years ended May 2, 1964 are the consolidated operations of Masters, Inc. and its th. wholly-owned subsidiaries. On May 2, 1964 the assets and business of the subsidiaries were liquida. into the parent company who continued their operations as divisions of the Company.

	Years Ended		
	April 30, 1962 (Unaudited)	April 30, 1963	May 2, 196-
Sales--leased departments	$ 6,894,182	$ 8,136,628	$ 7,127,586
Net Sales—own departments	$30,521,874	$25,065,325	$18,228,237
Leased department rentals and other income	638,462	834,264	846,700
Total	$31,160,336	$25,899,589	$19,074,937
Costs And Expenses:			
Costs of goods sold and occupancy costs (Note 2)	$27,161,572	$23,058,319	$16,237,709
Selling, buying, and general and administrative costs	4,054,091	3,853,023	2,875,092
Interest expense	61,315	37,149	14,724
	$31,276,978	$26,948,491	$19,127,525
Net income or (loss) before refund of federal income taxes	$ (116,642)	$(1,048,902)	$ (52,588)
Refund of federal income taxes (Note 9)	31,000	68,024	—
Net income or (loss)	$ (85,642)	$(980,878)	$ (52,588)
Special Items:			
Gain on sales of warehouse properties	$ 82,325	$ 180,930	—
Facilities disposed of and costs incurred in closing of stores	—	(870,772)	$ (86,700)
Additional obligations, forgiveness of indebtedness under plan of arrangement (Note 1) less applicable expenses..	—	$(680,623)	$ 2,906,012
	$ 82,325	$(1,370,465)	$ 2,819,312
Net income or (loss) and special items	$ (3,317)	$(2,351,343)	$ 2,766,724
Net income or (loss) per share (Note C)	$ (.17)	$ (2.10)	$ (.11)
Special items per share (Note C)	$ .16	$ (2.93)	$ 6.03

Notes:

(A) Numerical note references are to the Notes to Financial Statements appearing elsewhere in this Prox Statement.

(B) In order to conform to its natural business cycle, the Company changed its accounting year to the 52-5 week period ending nearest to January 31st of each year.

(C) Based on the number of shares outstanding at the end of each period.

(D) Masters, Inc. has paid no dividends during the period May 1, 1961 to July 30, 1966.

97A

	Nine Months Ended	Three Months Ended	Year Ended	Three Months Ended	
May 1, 1965	January 29, 1966 (Note B)	April 30, 1966 (Unaudited)	April 30, 1966	July 31, 1965 (Unaudited)	July 30, 1966
$ 8,329,562	$ 6,682,431	$ 1,941,907	$ 8,624,338	$ 2,205,8[illegible]0	$ 1,985,386
$21,330,206	$17,110,644	$ 4,282,839	$21,393,483	$ 5,511,383	$ 5,336,065
1,072,471	828,026	248,059	1,076,085	259,922	242,461
$22,402,677	$17,938,670	$ 4,530,898	$22,469,568	$ 5,771,305	$ 5,578,526
$18,775,725	$15,093,217	$ 3,860,342	$18,953,559	$ 4,892,793	$ 4,707,654
3,502,114	2,865,857	844,803	3,710,660	1,011,294	899,706
45,626	51,309	13,777	65,086	17,846	16,590
$22,323,465	$18,010,383	$ 4,718,922	$22,729,305	$ 5,921,933	$ 5,623,950
$ 79,212	$ (71,713)	$ (188,024)	$ (259,737)	$ (150,628)	$ (45,424)
—	—	—	—	—	—
$ 79,212	$ (71,713)	$ (188,024)	$ (259,737)	$ (150,628)	$ (45,424)
—	—	—	—	—	—
—	—	—	—	—	$ (561,367) (Note 8)
—	—	—	—	—	—
—	—	—	—	—	(561,367)
$ 79,212	$ (71,713)	$ (188,024)	$ (259,737)	$ (150,628)	$ (606,791)
$ .16	$ (.14)	$ (.37)	$ (.51)	$ (.30)	$ (.09)
—	—	—	—	—	$ (1.11)

MASTERS, INC.

BALANCE SHEETS

January 29, 1966 and July 30, 1966

ASSETS

	January 29, 1966 (Audited)	July 30, 1966 (Unaudited)
CURRENT ASSETS:		
Cash in banks and on hand	$ 566,247	$ 880,428
Accounts receivable (less estimated doubtful accounts of $12,858 and $16,[illegible]8 at the respective dates)	106,186	140,064
Due from sale of Miami, Florida stores (Note 8)	—	897,816
Due from vendors	146,211	89,040
Merchandise inventories (Note 2)	4,017,788	2,48[illegible],737
Other receivables	41,661	40,440
Prepaid expenses	69,581	38,986
TOTAL CURRENT ASSETS	$4,947,674	$4,574,511
PROPERTIES AT COST (Note 3):		
Store fixtures and equipment	$1,108,901	$ 539,796
Improvements to leaseholds	778,153	604,218
	$1,887,054	$1,144,014
Less Accumulated depreciation and amortization	830,066	735,502
	$1,056,988	$ 408,512
Security deposits	$ 97,264	$ 49,706
	$6,101,926	$5,032,729

The accompanying notes are an integral part of the financial statements

LIABILITIES

	January 29, 1966 (Audited)	July 30, 1966 (Unaudited)
CURRENT LIABILITIES:		
Accounts payable—trade	$1,713,585	$1,838,164
6% Series "B" Subordinated Debentures payable (Notes 4 and 8)	—	162,000
Certificate of indebtedness due within one year (Note 1)	332,660	332,300
Due to lessees	119,747	93,469
Customers' deposit	19,652	14,177
Accrued compensation and other expenses	89,141	217,290
Accrued taxes (other than income taxes)	261,251	178,458
TOTAL CURRENT LIABILITIES	$2,536,036	$2,835,858
LONG-TERM LIABILITIES:		
Certificates of indebtedness—due after one year (Note 1)	$ 277,214	$ 110,764
Subordinated indebtedness (Notes 4 and 8)	712,687	304,933
	$ 989,901	$ 415,697
Contingent liabilities and commitments (Note 5)	—	—

STOCKHOLDERS' EQUITY (NOTES 6, 7 AND 8)

COMMON STOCK—PAR VALUE $1:		
Authorized—1,500,000 shares—		
Issued—505,400 shares	$ 505,400	$ 505,400
Capital in excess of par value	695,170	695,170
Retained earnings (per accompanying statement)	1,375,419	580,604
	$2,575,989	$1,781,174
	$6,101,926	$5,032,729

MASTERS, INC.

STATEMENTS OF RETAINED EARNINGS

For the Period from May 1, 1963 to January 29, 1966, for the Three Months Ended April 30, 1966 and for the Three Months Ended July 30, 1966

	Years Ended May 2, 1964	Years Ended May 1, 1965	Nine Months Ended January 29, 1966 (Note A)	Three Months Ended April 30, 1966 (Unaudited)	Year Ended April 30, 1966 (Unaudited)	Three Months Ended July 30, 1966 (Unaudited)
Balance at beginning of period (Deficit) ...	$(1,398,804)	$ 1,367,920	$ 1,447,132	$ 1,375,419	$ 1,447,132	$ 1,187,395
Net income or (loss) and special items for the period	2,766,724	79,212	(71,713)	(188,024)	(259,737)	(606,791)
Balance at end of period	$ 1,367,920	$ 1,447,132	$ 1,375,419	$ 1,187,395	$ 1,187,395	$ 580,604

(NOTE A):

In order to conform to its natural business cycle the Company changed its accounting year to the 52-53 week period ending nearest to January 31st of each year.

The accompanying notes are an integral part of the financial statements.

MASTERS, INC.

NOTES TO FINANCIAL STATEMENTS

(Insofar as applicable to dates and periods subsequent to January 29, 1966, these notes are not covered by the reports of the independent certified public accountants.)

NOTE 1—PETITION FOR ARRANGEMENT:

On January 31, 1963, Masters, Inc. and its former principal operating subsidiary, Masters Stores, Inc. filed a petition for arrangement under Chapter XI of the Bankruptcy Act. On December 27, 1963, the United States District Court, Southern District, New York, confirmed the plan of arrangement. The plan provides, among other things, for payment to unsecured general creditors of 40% of their respective claims, 10% within sixty days after confirmation, and 30% payable in equal monthly instalments over forty-five months. Additional amounts, not exceeding 10% of unsecured creditors' claims are contingently payable in the event that 80% of the annual net income (before 50% of depreciation) exceeds the deferred payments made during the year.

Other provisions of the plan provide that:

a) The debtor procure an unsecured loan of $200,000 subordinated to the deferred payments due to the unsecured creditors (see Note 4).

b) Resignations of officers and directors be deposited with the Creditors' Committee.

c) The debtor accelerate the remaining balance of unpaid instalment payments in the event that cumulative operating losses subsequent to November 1, 1963 exceed $400,000. This amount shall be determined before depreciation and amortization and, in general, before extraordinary charges. The default may be cured by additional capital investment or subordinated loan in an amount by which said losses exceed $400,000.

d) Restrictions to be imposed upon opening or closing of stores; payment of dividends; capital distributions or bulk sales of assets without prior creditor approval.

e) The majority of the capital stock of the Company be deposited with the Creditors' Committee, who shall become the owner thereof in the event of default under the plan.

NOTE 2—MERCHANDISE INVENTORIES:

Merchandise inventories, consisting of merchandise purchased for resale, is stated at the lower of cost or market, as determined by the retail inventory method.

Merchandise inventories entering into the determination of cost of goods sold for the periods from May 1, 1963 to January 29, 1966, for the three months ended April 30, 1966, for the three months ended July 31, 1965 and July 31, 1966, are as follows:

May 1, 1963	$3,925,086
May 2, 1964	3,651,027
May 1, 1965	5,520,782
January 29, 1966	4,017,788
April 30, 1966	5,122,450
July 31, 1965	4,620,302
July 30, 1966	2,487,737

NOTE 3—PROPERTIES AT COST:

Provision has been made during the period for depreciation and amortization by applying substantially the following annual rates and methods:

	Method	Rate
Store fixtures and equipment	Straight-Line	10%
Improvements to leaseholds	Straight-Line	Lives of leases or 10% whichever was lower.

The fixed assets and related depreciation accounts were relieved during the period for assets retired or disposed of. Profits or losses in sale of fixed assets were charged or credited to operations or special items as required.

Expenditures for maintenance and repairs were charged to operations for the period. Expenditures for betterments and additions were capitalized.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 4—SUBORDINATED INDEBTEDNESS:

Subordinated indebtedness consists of:

	January 29, 1966	July 30, 1966
9% subordinated loan—due December 27, 1969	$283,000	$283,000
Accrued interest—non-current	17,687	21,933
6% subordinated debentures due 1970-75:		
Series A	250,000	—
Series B	162,000	—
	$712,687	$304,933

The 9% (6% payable currently) subordinated loan was procured in compliance with the terms of the plan of arrangement (see Note 1). The lenders were granted the option to subscribe to three shares of the $1 par value common stock for every $1 of loan at the rates of $1.25 per share to December 27, 1966 and $2 per share to December 27, 1968.

The 6% Series A and B debentures are subordinate to all sums due or to become due under the plan of arrangement and to future bank and other institutional loans obtained for operational purposes.

Options were granted to the holders to subscribe to that proportion of 35,000 shares of the $1 par value common stock as the principal dollar amount of debenture bears to $5[illegible]0,000 at the rate of $3.50 per share to 1966 and $4 per share from 1966 to 1969 (see Note 8).

NOTE 5—CONTINGENT LIABILITIES AND COMMITMENTS:

At balance sheet dates, the minimum annual rentals payable under leases, currently in effect, amounted to $627,800 and $295,900. The expiration dates and minimum annual rentals of the respective leases are as follows:

	Jan. 29, 1966	July 30, 1966
1967	$ 73,400	$ 73,400
1973	92,500	92,500
1974	80,000	80,000
1975	181,900	—
1977	50,000	50,000
1982	150,000	—
	$627,800	$295,900

Certain of the above leases provide for additional rentals based on sales volume.

NOTE 6—STOCK OPTIONS:

Pursuant to a plan approved on June 3, 1963 for restricted stock options to officers and key employees options to purchase 56,000 shares of the common stock at 10¢ per share, representing not less than 100% of the market value at the date of grant, were granted.

Options for 29,000 shares and 9,000 shares were exercised in March, 1965 and January, 1966 and options for the remaining 18,000 shares are exercisable equally over a two-year period. All options expire on June 3, 1968.

See "Outstanding Options" and "Transaction with a Former Officer".

NOTE 7—CAPITAL IN EXCESS OF PAR VALUE:

Capital in excess of par value of $729,370 on May 1, 1963 has been decreased by $34,200 by the exercise of stock options as mentioned in Note 6.

NOTE 8—EVENTS SUBSEQUENT TO BALANCE SHEETS:

On July 26, 1966 all of the merchandise inventory, store properties and business of the Miami, Florida, division were sold to Zayre Corp. The transaction resulted in a loss of $561,367 which was charged to "special item".

In connection with this sale, the Directors authorized the retirement of the 6% Series A and B debentures.

On September 6, 1966 the Company acquired as treasury stock, 44,668 of its shares at a cost of $89,336. (See "Transaction with a former officer".)

NOTES TO FINANCIAL STATEMENTS (Continued)

Note 9—Federal Income Tax:

The federal income tax returns for Masters, Inc. and its former subsidiaries have been examined by the Internal Revenue Service through the fiscal year ended April 30, 1963.

No provision has been required for federal income taxes because of operating losses.

The aggregate net operating loss carry-forward at January 29, 1966 was $2,578,849 which is available to the following expiration dates:

Year of loss	Carry-forward loss	Expiration date
1963	$ 274,045	1968
1964	2,200,423	1969
1965	32,304	1970
1966	72,077	1971
	$2,578,849	

Note 10—Supplementary Profit and Loss Information:

	Years Ended May 2, 1964	Years Ended May 1, 1965	Nine Months Ended January 29, 1966	Three Months Ended April 30, 1966	Three Months Ended July 30, 1966
Maintenance and repairs	$ 35,781	$ 56,524	$ 50,946	$ 18,388	$ 16,425
Depreciation and amortization	118,938	146,929	134,884	47,865	48,318
Taxes (other than federal income taxes)					
Payroll	113,532	137,952	108,505	33,278	36,742
State franchise	2,282	2,959	2,102	1,550	—
Other	35,224	46,528	34,286	10,712	—
Rents and royalties	517,477	597,037	523,592	170,197	169,3[illegible]

All of the above have been charged directly to profit and loss to accounts other than cost of sales.

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF LADY ROSE STORES, INC.:

We have examined the financial statements of LADY ROSE STORES, INC. AND SUBSIDIARIES and the related consolidated statements of income, included elsewhere herein, for the three years ended February 28, 1966. Our examination of the financial statements and the consolidated statements of income was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements and the related consolidated statements of income present fairly the financial position of LADY ROSE STORES, INC. AND SUBSIDIARIES at February 28, 1966, and the results of their operations for the three years then ended in conformity with generally accepted accounting principles which have been applied on a consistant basis.

KALISH, RUBINROIT & CO.

New York, N. Y.
May 10, 1966.

LADY ROSE STORES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

The following consolidated statements of income of Lady Rose Stores, Inc. and its Subsidiaries have been examined by the independent certified public accountants whose report thereon may be found elsewhere in this Proxy Statement. The statements of income for the six months ended August 31, 1965 and 1966 are unaudited; however, in the opinion of the Company, all adjustments, consisting only of the normal recurring accruals, necessary for a fair statement of the results for the unaudited six-month interim periods ended August 31, 1965 and 1966 have been made. The statements of income should be read in conjunction with the other financial statements and the accompanying notes appearing elsewhere in this Proxy Statement.

	Years Ended February 28,				(Unaudited) Six Months Ended	
	1963	1964	1965	1966	August 31, 1965	August 31, 1966
Sales	$ 7,380,944	$ 8,176,995	$11,194,080	$13,124,670	$ 5,854,592	$ 6,766,101
Less Cost of Sales (Note 2)	4,926,355	5,618,129	7,809,203	9,025,509	4,065,078	4,465,922
Gross profit on sales	$ 2,454,589	$ 2,558,866	$ 3,384,877	$ 4,099,161	$ 1,789,514	$ 2,300,179
Selling expenses	$ 2,030,318	$ 2,195,984	$ 2,894,581	$ 3,332,363	$ 1,378,938	$ 1,612,643
General and administrative expenses	63,517	58,484	64,033	86,821	176,375	203,545
	$ 2,093,835	$ 2,254,468	$ 2,958,614	$ 3,419,184	$ 1,555,313	$ 1,816,188
Net income before provision for federal income taxes	$ 360,754	$ 304,398	$ 426,263	$ 679,977	$ 234,201	$ 483,991
Provision for federal income taxes (Note B)	131,500	99,000	125,000	228,000	67,500	152,500
Net income	$ 229,254	$ 205,398	$ 301,263	$ 451,977	$ 166,701	$ 331,491
Net income per share (Note C)	$ 764.18	$ 684.66	$1,004.21	$1,506.59	$ 555.67	$1,104.97

The accompanying notes are an integral part of the financial statements.

NOTES:

(A) Numerical note references are to the Notes to Financial Statements appearing elsewhere in this Proxy Statement.

(B) The provision for federal income taxes is computed on an individual Company basis.

(C) Based on 300 shares outstanding at the end of each period.

(D) Lady Rose Stores, Inc. has paid no dividends during the period March 1, 1962 to August 31, 1966.

(E) Prior to March 1, 1962, Lady Rose Stores, Inc. and its subsidiaries were held by common ownership interests (see Note 1). Prior to the consolidation of those interests, the companies had various fiscal closing periods and therefore combined financial operating results are not readily ascertainable.

LADY ROSE STORES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

February 28, 1966 and August 31, 1966

ASSETS	February 28, 1966 (Audited)	August 31, 1966 (Unaudited)
CURRENT ASSETS:		
Cash in banks and certificates of deposit	$ 885,215	$1,195,713
Accounts and notes receivable from lessors	15,852	31,410
Merchandise inventory, at the lower of cost or market, as determined by the retail inventory method (Note 2)	1,953,563	2,255,024
Prepaid rent, insurance, etc.	68,819	60,059
Due from employees, etc.	58,700	29,301
Total current assets	2,982,149	3,571,507
Store fixtures, improvements and equipment, at cost (Note 3)	787,292	657,054
Less: Depreciation to date	428,010	375,019
	359,282	281,035
Advances for new operating units under construction	12,268	91,330
	371,550	372,365
OTHER ASSETS:		
Due from officers and stockholders	21,075	15,128
Investments at cost (Note 4)	217,698	167,448
Mortgages and notes receivable	54,126	46,126
Security deposits, etc.	72,705	110,063
	365,604	338,765
	$3,719,303	$4,282,637

LIABILITIES

CURRENT LIABILITIES:		
Accounts payable—trade	$1,037,062	$1,379,620
Accrued compensation and other expenses	115,116	82,170
Accrued taxes (other than federal income tax)	139,792	133,630
Federal income taxes payable	226,624	155,017
Total current liabilities	1,518,594	1,750,437
Contingent liabilities and commitments (Note 5)	—	—

CAPITAL

CAPITAL STOCK:		
Authorized and issued—300 shares Common Stock, no par value	30,000	30,000
Capital contributed in excess of no par value stock (Note 6)	190,075	190,075
Retained earnings (per accompanying statement) (Note 1)	1,980,634	2,312,125
	2,200,709	2,532,200
	$3,719,303	$4,282,637

The accompanying notes are an integral part of the financial statements.

LADY ROSE STORES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

For the Three Years Ended February 28, 1966, and the Six Months Ended August 31, 1966

	Years Ended February 28,			Six Months Ended August 31, 1966 (Unaudited)
	1964	1965	1966	
Balance at beginning of period	$1,021,996	$1,227,394	$1,528,657	$1,980,634
Net income for the period	205,398	301,263	451,977	331,491
Balance at end of period	$1,227,394	$1,528,657	$1,980,634	$2,312,125

The accompanying notes are an integral part of the financial statements.

LADY ROSE STORES, INC., AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

(Insofar as applicable to dates and periods subsequent to February 28, 1966, there notes are not covered by the reports of the independent certified public accountants.)

NOTE 1—PRINCIPLES OF CONSOLIDATION:

The consolidated statements include the accounts of Lady Rose Stores, Inc., and its subsidiaries, all of which are wholly-owned. All intercompany transactions have been eliminated.

The capital stock of certain companies held by common ownership interests was contributed to the Company by the respective shareholders on February 28, 1962. For accounting purposes, the acquisition was treated as a pooling of interests, and accordingly retained earnings include the accumulated earnings of the acquired companies from their respective dates of organization.

The Company states its investments in subsidiaries at cost (and at underlying book equity as at date of acquisition for those certain companies which were acquired through contribution by the common ownership interests referred to above). The excess of the carrying value of the net assets of the subsidiaries over the investment accounts amounts to $1,134,357 and $1,457,231 on February 28, 1966 and August 31, 1966 respectively. This represents the undistributed earnings of the subsidiaries since the dates of their acquisition and is included in retained earnings in the consolidated balance sheet.

Net income has not been reduced for income taxes that might result from the distribution of unremitted income of subsidiaries to the parent.

NOTE 2—MERCHANDISE INVENTORY:

Merchandise inventory consisting of merchandise purchased for resale, is stated at the lower of cost or market, as determined by the retail inventory method.

Merchandise inventory entering into the determination of cost of goods sold for the three years ended February 28, 1966 and for the six months ended August 31, 1965 and 1966 are as follows:

March 1, 1963	$1,179,972
February 28, 1964	1,374,241
February 28, 1965	1,940,785
February 28, 1966	1,953,563
August 31, 1965	2,163,432
August 31, 1966	2,255,024

NOTE 3—STORE FIXTURES, IMPROVEMENTS AND EQUIPMENT:

The store fixtures, improvements and equipment accounts are summarized as follows:

Store fixtures and equipment	$675,687
Leasehold improvements	74,771
Automotive equipment	36,834
	$787,292

Provision has been made during the period for depreciation and amortization by applying substantially the following annual rates and methods:

	Method	Rate
Store fixtures and equipment	Straight-line and declining balance	10%-20%
Leasehold improvements	Straight-line	10%
Automotive equipment	Straight-line	25%

The fixed assets and related depreciation accounts were relieved during the period for assets sold. Profits or losses on sale of fixed assets were charged or credited to operations.

Expenditures for maintenance and repairs were charged to operations for the period. Expenditures for betterments and additions were capitalized.

NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 4—INVESTMENTS:

In April, 1963 Lady Rose Stores, Inc. became a member of a group of investors which acquired controlling interest in the capital stock of Masters, Inc. The Company's investment in this venture at February 28, 1966 and August 31, 1966 was $210,000 and $160,000 which, at balance sheet date, did not exceed the book value of the underlying net assets (see also "Interests of Directors and Officers and Their Associates in the Proposed Merger" elsewhere in this Proxy Statement).

NOTE 5—CONTINGENT LIABILITIES AND COMMITMENTS:

At Feburary 28, 1966, the minimum annual rentals payable under leases amounted to $943,930. The expiration dates and minimum annual rentals of the respective leases are as follows:

1966	$ 99,300
1967	193,400
1968	49,500
1969	126,580
1970	128,800
1971	120,000
1972	118,000
1973	67,350
1974	22,000
1976	19,000
	$943,930

Certain of the foregoing leases provide for additional rentals based on sales volume.

NOTE 6—CAPITAL CONTRIBUTED IN EXCESS OF NO PAR VALUE STOCK:

Capital contributed in excess of no par value stock of $190,075 has not changed since March 1, 1963.

NOTE 7—PENSION PLAN:

On January 15, 1965, the Company adopted a non-contributory trusteed pension plan to provide retirement security for certain eligible employees.

Employees are generally eligible after 3 years of continuous service. The plan provides for retirement income at age 65 or after 10 years participation in the plan, whichever is later.

The estimated annual cost of the plan is $45,000 and under the method of funding there is no past service liability at February 28, 1966.

NOTE 8—SUPPLEMENTARY PROFIT AND LOSS INFORMATION:

	Years Ended February 28,			Six Months Ended
	1964	1965	1966	August 31, 1966
Maintenance and repairs	$ 11,518	$ 29,288	$ 28,517	$ 17,008
Depreciation and amortization	58,778	78,629	59,699	32,233
Taxes (other than federal income taxes)				
Real estate and personal property	25,032	25,781	30,748	16,000
Social Security	63,440	81,295	91,563	50,961
State franchise	16,791	24,343	31,956	22,880
Other	32,597	37,474	25,724	12,559
Rents and royalties	661,592	879,486	1,000,264	521,322

All of the above has been charged directly to profit and loss to accounts other than cost of sales.

PRO FORMA COMBINED SUMMARY BALANCE SHEET

(Giving effect to the proposed merger of Lady Rose Stores, Inc. and Subsidiaries into Masters, Inc.)

The following pro forma combined summary balance sheet, giving effect to the proposed merger of Lady Rose Stores, Inc. and Subsidiaries into Masters, Inc. on a pooling of interests basis, combines the balance sheet of Masters, Inc. at July 30, 1966 and the consolidated balance sheet of Lady Rose Stores, Inc. and Subsidiaries at August 31, 1966. The pro forma combined summary balance sheet should be read in conjunction with the financial statements of Masters and Lady Rose and the related notes to the respective financial statements appearing elsewhere in this Proxy Statement.

	Masters, Inc. July 30, 1966	Lady Rose Stores, Inc., and Subsidiaries August 31, 1966	Pro Forma Adjustments add (deduct)	Pro Forma Combined Balance Sheet
Cash	$ 880,428	$1,195,713	$(103,016)(1)	$1,973,125
Merchandise inventories	2,487,737	2,255,024		4,742,761
Other current assets	1,206,346	120,770		1,327,116
	$4,574,511	3,571,507		$8,043,002
Less Current liabilities	2,835,858	1,750,437		4,586,295
Working capital	$1,738,653	$1,821,070		$3,456,707
Investment in Masters Inc.	—	160,000	(160,000)(2)	—
Property accounts (Net)	408,512	372,365		780,877
Other assets	49,706	178,765		228,471
Long-term debt	(415,697)	—	80,000 (2)	(335,697)
	$1,781,174	$2,532,200	$(183,016)	$4,130,358
Stockholders' equity				
Common stock—$1 par value	505,400		(44,668)(1) (69,630)(2) 1,750,000 (3)	2,141,102
Common stock—no par value		30,000	(30,000)(3)	—
Preferred stock—5% non-cumulative convertible, $1,000 par value			1,750,000 (3)	1,750,000
Capital in excess of par value	695,170	190,075	(58,348)(1) (10,370)(2) (816,527)(3)	—
Retained earnings	580,604	2,312,125	(2,653,473)(3)	239,256
	$1,781,174	$2,532,200	$(183,016)	$4,130,358

The pro forma adjustments give effect to the following:

1.) Redemption of 51,868 shares at $2 per share, after issuance of 7,200 shares, under option. See "Transaction with a Former Officer".

2.) Elimination of Lady Rose's investment in Masters.

3.) Conversion of Lady Rose stock for Masters $1 par value common stock and 5% non-cumulative convertible $1,000 par value preferred stock.

PRO FORMA COMBINED SUMMARY OF INCOME

(Giving effect to the proposed merger of Lady Rose Stores, Inc. and Subsidiaries into Masters, Inc.)

The following pro forma combined summary of income has been prepared by combining amounts shown in separate statements of income of Masters, Inc. and Lady Rose Stores, Inc. and Subsidiaries (without regard to differing fiscal periods). The pro forma combined summary of income should be read in conjunction with the separate statements of income of Masters and Lady Rose and notes thereto included elsewhere in this Proxy Statement.

	1963	1964	1965	1966	First Three Months (D) 1966	First Three Months (D) 1967
Income						
Sales	$3[illegible].446,269	$26,405,232	$32,524,286	$34,518,153	$8,471,664	$8,821,378
Leased department rentals and other income (Note A)	602,892	635,983	803,116	778,587	185,548	174,975
Total	$3[illegible],049,161	$27,041,215	$33,327,402	$35,296,740	$8,657,212	$8,996,353
Net income or (loss)	$ (751,624)	$ 152,810	$ 380,475	$ 192,240	$(67,843)	$ 121,439
Special items (Note B)	(1,370,465)	2,819,312	—	—	—	(561,367)
Net income or (loss) and special items	$(2,122,089)	$ 2,972,122	$ 380,475	$ 192,240	$ (67,843)	$ (439,928)
Per share (Note C)						
Net income or (loss)	$ (.19)	$ .40	$ .10	$ .05	$ (.02)	$ .03
Special items	$ (.35)	$ .72	—	—	—	$ (.14)
Net income or (loss) and special items	$ (.54)	$ .76	$ .10	$ .05	$ (.02)	$ (.11)

NOTES:

(A) After elimination of intercompany transactions.

(B) Details of amounts included herein are available from separate statements of income of Masters.

(C) Based upon 3,891,1[illegible]2 common shares to be outstanding after full conversion of the preferred stock as required by the plan of merger.

(D) Based upon the three months ended July 31, 1965 and 1966 of Masters, combined with the three months ended August 31, 1965 and 1966 of Lady Rose.

112A

Px4

MINUTES OF SPECIAL MEETING

- of the -

BOARD OF DIRECTORS

- of -

MASTERS, INC.

MINUTES OF A SPECIAL MEETING OF THE BOARD OF DIRECTORS OF MASTERS, INC. HELD AT THE OFFICES OF FELDSHUH & FRANK, ESQS., 144 EAST 44th STREET, NEW YORK, NEW YORK, ON OCTOBER 31, 1966, at 3:30 P.M.

Mr. Louis Biblowitz, Chairman of the Board, announced that the following, being all the directors of the Company were present:

LOUIS BIBLOWITZ,	CHAIRMAN OF THE BOARD
MAX BIBLOWIT	
JOSHUA BIBLOWITZ	
ARNOLD GINSBURG	
HERBERT KURTZ	
HERBERT ABRAMSON	
RALPH J. WEINER	
HARRY GRUNTHER	
HARRY L. LEWIS	
PINCUS PETERSEIL	

The following were present at the invitation of the Board:

KENNETH KOPPELSON,	SECRETARY-TREASURER
I. BUD ROCKOWER	
KALISH & RUBINROIT,	CERTIFIED PUBLIC ACCOUNTANTS FOR THE COMPANY By: Hyman Rubinroit and Bernard Mintz
HERMAN SASSOWER, ESQ., and HOWARD WARD, ESQ.,	SPECIAL COUNSEL FOR LADY ROSE STORES, INC.
SIDNEY FELDSHUH, ESQ., and MARTIN M. FRANK of FELDSHUH & FRANK,	COUNSEL FOR THE COMPANY

(4)

Exh. 3

The Secretary announced that pursuant to the By-Laws, notice of this Special Meeting had been duly mailed to all directors on October 24, 1966.

The Chairman announced that the purpose of the meeting was to consider by wayof merger Masters' acquisition of Lady Rose Stores, Inc. (Lady Rose). Thereupon, a plan of merger was submitted, the substantial elements of which were as follows:

i) Without any cash outlay and in exchange for its stock, Masters, Inc. shall acquire all the issued and outstanding shares of Lady Rose.

ii) The Secretary-Treasurer of the Company reported the net worth of the Company after giving effect to all obligations and the loss incident to the disposal of the Florida stores, to be approximately between $1,600,000 and $1,700,000.

iii) The net worth of Lady Rose was reported as of August 31, 1966 at $2,532,206.

iv) The after tax earnings of Lady Rose projected to January 31, 1967, was reported and estimated to be $600,000.

v) The earnings of the Company projected to January 31, 1967 would show, according to the opinion of the Secretary-Treasurer, a "break-even" or at best, a small profit.

vi) A pro forma balance sheet for the merged Company reflected a net worth of over $4,000,000.

vii) The major terms of acquisition by Masters, Inc. were as follows:

a) Masters would increase its authorized capital of 1,500,000 shares to 4,500,000 shares of $1.00 par value common stock. Said stock to continue to be the sole voting stock of the Company.

b) A new class of $1,000, 5% non-cumulative, non-voting preferred stock shall be created. Such preferred stock would have preference only as to payment of dividends. In all other respects, e.g., liquidation, dissolution, etc., and prior to the mandatory conversion into common stock, as hereafter referred to, the preferred stock would possess no preference and would stand on the same footing (pari passu) as the common stock. This stock shall, and must be converted into the $1.00 par value common stock on February 1, 1972. The authorized issue would be $2,000,000 consisting of 2,000 shares of the aforesaid $1,000 preferred shares.

c) Upon the merger, Masters, Inc. would issue 1,750,000 shares of the common stock and 1,750 shares of the preferred stock as full consideration to the holders of Lady Rose stock, for assignment and transfer of all Lady Rose stock and in discharge of the debt of the Company to Lady Rose in the amount of $80,000 represented by the Lady Rose participation in the Subordinated Loan of $283,000, which participation shall be deemed fully paid thereby leaving a balance of said loan due to others of $203,000. Also the foregoing exchange includes the stock investment of $80,000 heretofore made by Lady Rose in Masters. In effect, therefore, the $80,000 debt as well as the

stock interest of $80,000 shall be incorporated within the consideration for the foregoing common and preferred shares.

d) The Company has a carry-forward loss of about $3,378,849 which the accountants for the Company have advised may be applied (subject to a ruling by the Internal Revenue Service) against the future earnings of the merged companies. Assuming that the pattern of performance of Lady Rose continues in the projected amount of $600,000 annual earnings then the aforesaid carry-forward loss would enable all earnings of the merged company to be after tax earnings, to the full extent of said loss.

After considerable discussion participated in by all directors, it was unanimously

RESOLVED, that this Special Meeting be adjourned for one week to 3:30 P.M. on November 7, 1966 at which time it will be reconvened for the purpose of giving further consideration to the aforesaid merger plan.

Secretary

116 A

MINUTES OF THE ADJOURNED AND RECONVENED SPECIAL MEETING

- of the -

BOARD OF DIRECTORS

- of -

MASTERS, INC.

MINUTES OF THE ADJOURNED AND RECONVENED SPECIAL MEETING OF THE BOARD OF DIRECTORS OF MASTERS, INC., HELD AT THE OFFICES OF FELDSHUH & FRANK, ESQS., 144 EAST 44th STREET, NEW YORK, N.Y., AT 3:30 P.M., ON OCTOBER 31, 1966.

The Chairman of the Board announced that by reason of his position in Lady Rose Stores, Inc. as President, Director and a major stockholder, the chairmanship of this adjourned and reconvened Special Meeting would be turned over to SIDNEY FELDSHUH, ESQ., of Counsel, for the Company.

Mr. Feldshuh announced that pursuant to the resolution duly adopted by the Board at its Special Meeting on October 31, 1966, adjourning that Special Meeting to November 7, 1966, this adjourned and reconvened Special Meeting was duly called by an appropriate notice mailed on November 1, 1966 by the Secretary to all directors.

The following directors were present:

LOUIS BIELOWITZ, CHAIRMAN OF THE BOARD
MAX BIELOWITZ
JOSHUA BIELOWITZ
ARNOLD GINSBURG
HERBERT KUNTZ
HERBERT ABRAMSON
RALPH J. WEINER

PX5

Exh 4

5

HARRY GRUNTHER
PINCUS PETERSEIL

Absent:

HARRY L. LEWIS

The following were present at the invitation of the Board:

KENNETH KOPELSON	SECRETARY-TREASURER
KALISH & RUBINROIT,	CERTIFIED PUBLIC ACCOUNTANTS FOR THE COMPANY By: Hyman Rubinroit and Bernard Mintz
HERMAN SASSOWER, ESQ., and HOWARD WARD, ESQ.	SPECIAL COUNSEL FOR LADY ROSE STORES, INC.
SIDNEY FELDSHUH, ESQ. and MARTIN M. FRANK OF FELDSHUH & FRANK,	COUNSEL FOR THE COMPANY
JOHN W. FROMMER, ESQ.	OF COUNSEL FOR BAC DISCOUNT STORES

In response to a question by Mr. Kurtz, Mr. Feldshuh stated that the professional people, that is Counsel and Certified Public Accountants to the Company, had the function and acted solely in the capacity of reporting facts relative to the merger plan. They are not advocating the adoption or rejection of the plan or any part thereof. The Directors alone should weigh and determine the action to be taken, and it was in this frame work that comments by Counsel and Accountants are to be weighed and considered by the Directors.

Counsel to the Company reported that the merger plan was contingent upon the following:

a) Obtaining the approval of the Board of Directors of the Merger Plan and approval to its submission to the stockholders;

b) The consent of the holders of the Certificates of Participation in the Subordinated Loan relinquishing their options to exchange said certificates for the stock of the Company in accordance with the provisions of said certificates;

c) The approval by the shareholders of 66-2/3rds% of the issued and outstanding common shares of the company;

d) The consent of the Creditors' Committee appointed under the Plan of Arrangement.

e) A ruling by the Internal Revenue Service qualifying the merger effective as of January 31, 1957 as a tax-free exchange under the provisions of Section 368(a) (1) (A) and Section 382(b) of the Internal Revenue Code of 1954.

f) The affirmative votes of 66-2/3rds% of the shareholders of Lady Rose.

Mr. Feldshuh reported that the following changes in the merger plan had been suggested by several directors:

i) The balance of the Subordinated Loan of $203,000 shall be continued as an obligation of the merged Company earning interest and being paid as to principal in accordance with its terms.

ii) The mandatory conversion date of the proposed preferred shares to be February 1, 1973 instead of

February 1, 1972.

Comments with respect to the plan were then made by Messrs. Kurtz, Weiner, Peterseil, Abramson and Ginsburg.

Thereupon, Mr. Kopelson, the Treasurer of the Company, was called upon to report upon the posture of the Company and his opinion of the effects of the merger upon (9) the Company. Mr. Kopelson reported that the net worth of the Company following the disposal of the Florida stores was approximately $1,600,000 to $1,700,000. He stated that the cash paid by the purchaser of the Florida stores had been fully utilized by the Company in the payment of Florida creditors, the subordinated A and B debentures, the acquisition of shares from Mr. Haizen, obtaining a certificate of deposit of $100,000 in connection with the payment of creditors under the Plan of Arrangement and the deposit of $50,000 in security incident to the renewal of the 48th Street store lease. He pointed out that in the usual and regular course of business of the Company, the Company at this time of the year borrowed substantially from banks. However, up to the present time, the Company has not borrowed any such monies, but he anticipates that it will shortly do so.

Mr. Kopelson further reported that the Company is facing a difficult operating situation. He stated that from an operating viewpoint, it is important for the Company to acquire a fifth location so that its advertising, general

and administrative expenses can be spread over a greater volume than that arising out of the four present locations. He also stated that the Company experienced great difficulty in effecting lease arrangements because of the competition for locations by competitors and others possessing a better financial position than the Company. In his judgment, the merger plan will lift the Company to a far better financial stature, thereby enabling the Company to deal more effectively in securing a fifth location as well as in dealing with suppliers.

Following Mr. Kopelson's report, further discussion was had and various questions were propounded to Counsel and to the Accountants.

Mr. Feldshuh then announced that Mr. Harry L. Lewis, a director, had telephoned Mr. Feldshuh advising that he could not attend this adjourned, reconvened Special Meeting, but instructed Mr. Feldshuh to state to the Board that if Mr. Lewis were present, he would approve the merger plan and would vote for its submission to the shareholders for their approval.

There being no further discussion, the following resolution was proposed by Mr. Weiner and seconded by Mr. Ginsburg:

> RESOLVED, by the Board of Directors of Masters, Inc. that a joint agreement for merger and acquisition by Masters, Inc. of Lady Rose Stores, Inc. substantially containing the terms and conditions outlined in the minutes of these Special Meetings (as adjourned and reconvened), be entered into and

RESOLVED FURTHER, that such agreement embodying such terms, be submitted to the shareholders of Masters, Inc., at a Special Meeting thereof, which meeting shall be called for at the earliest possible date permitted under the By-Laws for the purpose of taking such agreement into consideration and that notice, time, place and object of such meeting shall be given, mailed and published as required by law and the By-Laws of the Company, and

RESOLVED FURTHER, that if such agreement shall be adopted by the stockholders as required by law at such meeting or any adjournment thereof, the designated or proper officers of the Company be, and they are hereby authorized and directed to take such steps including amending the Certificate of Incorporation, and to do such other things to effectuate and consummate such agreement as may be prescribed by law or as to them may seem proper or necessary in the premises, and

RESOLVED FURTHER, that for the purposes of said meeting, the common stock transfer books of the Company be closed on the 30th day of November, 1966 at 3:00 o'clock in the afternoon of said day.

Thereupon, Mr. Feldshuh called for a vote upon the resolutions. The votes of the directors were polled as follows:

LOUIS BIBLOWITZ, CHAIRMAN ...... Aye
JOSHUA BIBLOWITZ .... Aye
MAX BIBLOWIT .... Aye
HERBERT ABRAMSON .... Aye
HARRY GRUNTHER .... Aye
RALPH WEINER .... Aye
ARNOLD GINSBURG .... Aye
PINCUS PETERSEIL .... Aye
HERBERT KURTZ .... Nay

Mr. Kurtz voted nay upon the resolutions, but directed that the following comment made by him be incorporated in the minutes:

"I am in favor of the merger. My disagreement is only with the values that were reached as a basis for the merger. I think the merger will be good for the Company".

Mr. Feldshuh then declared the resolutions passed and that in accordance with such resolutions, appropriate steps would be undertaken immediately to implement them.

There being no further business, upon unanimous consent the meeting was adjourned.

Secretary

PX 72

123A

COHEN, ROSENBAUM & SCHER
COUNSELLORS AT LAW
744 BROAD STREET
NEWARK, N.J. 07102

LOUIS J. COHEN
LAURENCE N. ROSENBAUM
MEYER H. SCHER
MARTIN D. COHEN

PHILIP KLEIN
OF COUNSEL

March 2, 1967

Kalish, Rubinroit & Co.
165 Broadway
New York, New York 10006

Re: Merger of Lady Rose Stores, Inc. with Masters, Inc.

Att: Mr. Bernard Mintz

Gentlemen:

It is with great pleasure that I enclose a copy of the ruling issued by the Treasury Department under date of February 28, 1967 granting, in all anticipated respects, the request for ruling filed on behalf of the above corporations and their respective stockholders.

Although Item (9), on page 4 of the ruling does not exclude the applicability of Section 269, it is to be noted that the third paragraph on page 2 of the ruling sets forth as a statement of fact the important, genuine business reason for the merger, thus making it virtually certain that Section 269 cannot be held applicable to deny Masters, Inc., the net operating loss carry-overs otherwise available.

I am gratified, as I am sure you must be, that our combined efforts in this matter have culminated so completely in success.

I have taken the liberty of sending a copy of the ruling together with a letter substantially the same as this one to Herman Sassower, Esquire, Sidney Feldshuh, Esquire, Masters, Inc. and Mr. Louis Biblowitz.

Sincerely yours,

Martin D. Cohen

MARTIN D. COHEN

For Cohen, Rosenbaum & Scher

MDC:JR
Enc.

124 A

U.S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

IN REPLY REFER TO
T:I:R:3

FEB 28 1967

Masters, Inc.
135-21 38th Avenue
Flushing, New York 11354

Gentlemen:

This is in reply to a letter dated December 28, 1966, requesting a ruling as to the Federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated January 10, January 20, and January 26, 1967. The relevant facts submitted are summarized in the following paragraphs.

Masters, Inc. ("Masters"), employer identification number 11-1895641, is a New York corporation engaged in the business of selling a complete line of department store items at retail. As of December 28, 1966, there were outstanding 469,732 shares of Masters common stock with a par value of $1 per share.

Lady Rose Stores, Inc. ("Lady Rose"), employer identification number 13-1912648, is a New York corporation engaged in the sale, at the retail level, of ladies' soft goods and apparel items. Its business is conducted through 21 wholly owned subsidiaries which are identified in exhibit J submitted in a letter dated December 28, 1966. As of December 28, 1966, there were outstanding 300 shares of Lady Rose no par value common stock. All of this stock was owned by four shareholders.

On November 15, 1966, Masters and Lady Rose entered into a written agreement wherein Lady Rose will liquidate its 21 wholly owned subsidiaries and merge into Masters pursuant to New York law. Masters will be the surviving corporation. Each Masters shareholder will exchange his Masters stock for an equal amount of new Masters common stock, par value $1 per share. At the same time each Lady Rose shareholder will exchange his Lady Rose stock for new Masters stock at the ratio of one share of Lady Rose common stock for 5,833 1/3 shares of Masters common stock, par value $1 per share, and 5 5/6 shares of Masters five percent noncumulative convertible $1,000 par value preferred stock. All stores presently operated by Masters and all the 18 leased departments, as well as the three stores presently operated by Lady Rose subsidiaries, will continue in full operation without change.

In January 1963 Masters filed a petition in Chapter XI proceedings in the Bankruptcy Court of the Southern District of New York. A plan of arrangement was confirmed, whereby Masters was obliged to pay out, in periodic monthly installments, a portion of the debts it owed creditors. A creditors' committee was formed to help carry out the plan of arrangement.

However, Masters deficit became larger. A report made by independent certified public accountants showed that Masters had an operating deficit of $2,705,583 since the adoption of the plan of arrangement. The creditors decided that Masters needed fresh capital assets to stop its deteriorating financial situation. Accordingly, the creditors' committee gave its consent for the merger described above.

Lady Rose leases departments in the Masters New York stores. Prior to the plan of arrangement Lady Rose had leased large departments in virtually all the stores operated by Masters. The principal reason for Lady Rose's heavy involvement in Masters plan of arrangement was the necessity to protect its position as lessee in the several stores operated by Masters. Lady Rose is constantly seeking ways to maintain and improve its competitive position. The loss of its valuable licenses was greater to Lady Rose than the possible loss of its investment in Masters. The merger of Lady Rose into Masters will guarantee the continuance of its businesses in the Masters stores.

There is no present intention on the part of the Masters and Lady Rose shareholders to dispose of the Masters stock they receive in the exchange mentioned above. It is represented that the Masters and Lady Rose shareholders will pay their own expenses arising out of or incidental to the transaction.

The 21 Lady Rose subsidiaries do not have any net operating loss carryovers. It is represented that each of the Lady Rose subsidiaries formed on and after July 15, 1965, came into being in a transaction qualifying under section 351(a) of the Internal Revenue Code. It is also represented that the holders of Masters stock immediately before the merger will own immediately after the merger more than 20 percent of the fair market value of the outstanding stock (excluding preferred) of the surviving company.

Based solely upon the information submitted, it is held as follows:

(1) In accordance with section 332(a) of the Internal Revenue Code, no gain or loss

will be recognized to Lady Rose upon its receipt of all the assets and liabilities of the 21 subsidiaries pursuant to the complete liquidation of these subsidiaries, provided all of the requirements of section 332(b) of the Code are met.

(2) As provided by section 334(b)(1) of the Code, the basis to Lady Rose of the property received as a result of the complete liquidation of each of the 21 Lady Rose subsidiaries will be the same as the basis of such property in the hands of the distributing Lady Rose subsidiary immediately prior to the transaction.

(3) Provided the merger of Lady Rose into Masters is a statutory merger pursuant to the laws of New York, it will be a reorganization within the meaning of section 368(a)(1)(A) of the Code.

(4) Under section 361(a) of the Code, no gain or loss will be recognized to Lady Rose upon the transfer of its assets to Masters solely in exchange for Masters stock and the assumption by Masters of the Lady Rose liabilities. No gain or loss will be recognized to Masters upon the receipt of the assets of Lady Rose in exchange for its stock (section 1032(a) of the Code).

(5) In accordance with section 362(b) of the Code, the basis to Masters of the Lady Rose assets received in the merger will be the same as the basis of those assets in the hands of Lady Rose immediately prior to the transfer.

(6) As provided in section 354(a) of the Code, no gain or loss will be recognized to the Masters and Lady Rose shareholders upon the exchange of their stock solely for Masters stock, as described above.

(7) In accordance with section 358(a) of the Code, the basis of the new Masters stock received by each Masters shareholder on the exchange will be the same as the basis of the Masters stock surrendered therefor. The basis of the new Masters common and preferred stock received by each Lady Rose shareholder will be the same as the basis of the Lady Rose stock surrendered in exchange therefor allocated between the Masters common and preferred stock in proportion to the fair market value of each in accordance with section 1.358-2 of the Income Tax Regulations.

(8) The Masters preferred stock which will be received by the Lady Rose shareholders in the proposed exchange will be "section 306 stock" within the meaning of section 306(c) of the Code.

(9) Subject to the possible applicability of the limitation provisions of section 269 of the Code, Masters, as the acquiring corporation, will succeed to and take into account immediately after the reorganization its own net operating loss carryovers determined under section 172 of the Code.

(10) Section 382(a) of the Code will not apply to this transaction because this section is not applicable where there is a reorganization under section 368(a)(1)(A) of the Code. Provided the Masters shareholders, immediately before the reorganization, own at least 20 percent of the fair market value of the outstanding stock of the acquiring corporation immediately after the reorganization, section 382(b) of the Code, which places a limitation on the carryover of net operating losses in the case of certain reorganizations, is not applicable because of the language of the statute excluding a reorganization under section 368(a)(1)(A) of the Code where the shareholders of the

128 A

acquiring corporation, immediately before the reorganization, own more than 20 percent of the acquiring corporation immediately after the reorganization.

No opinion is expressed as to the tax treatment of the transactions under the provisions of any of the other sections of the Code and Regulations which may also be applicable thereto or to the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions which are not specifically covered by the above rulings.

It is important that a copy of this letter be attached to the Federal income tax returns of Masters and Lady Rose for the taxable year in which the transactions covered by this ruling are consummated.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Mr. Martin D. Cohen.

Very truly yours,

John F. Bogaard

Chief, Reorganization Branch

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

129A

PX 128

PX 128

---x

ANTOINETTE M. BRAGALINI, ARNOLD DAMSKY, WILLIAM WEINSTOCK, CARL ROGERS and ROSE ROGERS, H. L. FEDERMAN & CO., INC., SUZANNE MASTERS, STEPHEN MASTERS and NORMAN KEMPER, individually, and as Stock holders of MASTERS, INC., suing in behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs,

-against-

LOUIS BIBLOWITZ, MAX BIBLOWIT, JOSHUA BIBLOWITZ, RALPH J. WEINER, JOEL BIBLOWITZ, ARNOLD GINSBURG, HERBERT ABRAMSON, HARRY GRUNTHER, HARRY L. LEWIS, PINCUS PETERSEIL and MASTERS, INC.,

Defendants.

---x

Docket No.
67 Civ. 4988

Calendar No.534(4)

PRETRIAL ORDER

On March 20, 1972, the attorneys for the parties to this action appeared before the Court at a pre-trial conference pursuant to local Calendar Rules 6 and 13 and Rule 16 of the Federal Rules of Civil Procedure, and the following action was taken.

1. The pleadings were agreed to be deemed amended in accordance with the framing of the issues in this action in paragraph 9 of this pre-trial order.

2. The parties agreed that the trial of this action should be based upon this order and upon the pleadings as amended. No issues raised by the pleadings have been abandoned.

3. (a). The parties stipulated that the following facts are not in dispute in this action (each party reserving the right to object to the materiality of any such stipulated fact and its relevancy to the issues):

(a) 1. The terms of the merger were as follows: Masters issued to the Lady Rose stockholders 1,750,000 shares

of its common capital stock and 1,750 shares of a new 5% non-cumulative preferred stock, par value $1,000 which preferred stock must be converted on February 1, 1973 into 1,750,000 shares of common stock. Upon such conversion, Lady Rose would receive 3,500,000 shares of the common stock of Masters. Masters, prior to the merger had 460,732 shares of common stock issued and outstanding in the hands of the public. Lady Rose owned, via voting trust certificates, 69,629-1/27ths shares of Masters which were cancelled under the terms of the merger. Lady Rose would receive after conversion 3,500,000 shares of Masters common stock or 89.95% and the public stockholders of Masters (including directors other than the Biblowitzs) retained 391,102 shares of Masters common stock or 10.05% of the newly issued and outstanding stock. Lady Rose distributed all the Masters shares received by it to the defendants Biblowitz.

The preferred stock in Masters received by Messrs. Biblowitz differed from the common stock in that it was entitled to non-cumulative dividends at the rate of 5% per annum before dividends could be paid to the holders of the common stock, was non-voting and non-redeemable.

The plan contemplated a minimum 20% equity in the $1 par value common stock of the minority shareholders until January 31, 1973.

The plan as drafted qualified for the carry-forward loss of Masters of approximately $3,378,849 as a net operating loss deduction against the future earnings of the merged companies, if any.

(a) 2. On July 26, 1966 Masters sold all of its merchandise inventory, store properties and business of its Florida division, consisting of three stores, to Zayre Corp.

and its subsidiaries. Masters sustained operating losses in its Florida division for the six months ending October, 1965 to the extent of $252,000 and for the nine months ending January 29, 1966 in the amount of $158,702. The foregoing operational losses prompted the directors to approve the sale of the Miami stores.

For the six months ended July 30, 1966 Masters had a stated operating loss of $212,294 for its discontinued Florida division and a non-operating loss of $561,367 on the sale to Zayre.

As a consequence of the sale to Zayre, Masters had a stated net cash inflow of approximately $1,508,000 after a full retirement of its Subordinated A and B Debentures in the amount of $250,000 and $162,000. (However, see defendants' contention No. C-7, page 36, for defendants full contention re this fact).

As of September 6, 1966, Masters had a remaining indebtedness to Chapter XI creditors (originally $1,400,000) of $393,000 and payments under the Plan of Arrangement would in the ordinary course be completed on or about November, 1967.

Louis Biblowitz at the Annual Meeting of Stockholders of Masters, Inc., on September 8, 1966 after the sale to Zayre, stated in response to a comment from shareholders of Masters to the effect that the attention of the Board of Directors should be brought to the possible shift of Masters' operations to a full concessionaire operation that no change was contemplated in the operational policy of Masters.

The Board of Directors of Masters on September 8, 1966 authorized the renewal of the Company's lease of the premises 64-70 West 48th Street, City and State of New York, for a term of 5 years commencing May 1, 1967 to April 30, 1972.

(a) 3. (a) As of July 30, 1966, after the sale to Zayre, the working capital of Masters was $1,856,595; its

book value was $1,677,438 or $3.70 per share.

(b) As of August 31, 1966, the working capital of Lady Rose was $1,821,076; its book value was $2,532,206.

(a) 4. <u>Masters tax-loss carryforward</u>. In valuing Masters, its tax loss carryforward was considered.

As of October 30, 1966, the projected tax loss carryforward of Masters for the fiscal years 1963 through 1967 was $3,378,849. The carryforward losses and their years of expiration are shown below:

Year of Operating Loss	Carry-forward Loss	Date of Expiration
4/30/63	$ 274,045	1/31/68
5/2/64	2,200,423	1/31/69
5/1/65	32,304	1/31/70
1/31/66	72,077	1/31/71
1/31/67	800,000 (est.)	1/31/72
	$3,378,849	

Of the estimated loss of $800,000 for fiscal 1967, over $773,000 was attributable to the discontinued Florida division.

The Board of Directors of Masters was advised:

> An important tax aspect of this plan is the availability of the carry-over loss without the reduction described in Sec.382(b) because the stockholders of Masters, Inc. (the loss corporation) retain at least 20% of the stock of the acquiring corporation. Under the law, (Sec. 382(b)) a reduction in the carry-forward loss of 5% is required for each 1% of equity below 20% not retained by the stockholders of the loss corporation in the surviving corporation. (Example - if the loss corporation stockholders retain only 10% in the merged company, then only 50% of the loss carry-over is available)."

The minutes of Masters' Board of Directors meeting of October 31, 1966 recites that Kalish, Rubinroit & Co., the accountants for Masters and Lady Rose advised the Board of Directors of Masters on October 31, 1966 that in their

opinion but subject to a ruling by the Internal Revenue Service, Masters' tax loss carryforward of approximately $3,378,849 could be applied against the future earnings of the merged company* and assuming that the pattern of performance of Lady Rose continued in the projected amount of $600,000 annual earnings, then the aforesaid carryforward loss would enable all earnings of the merged company to be after tax earnings, to the full extent of said loss. In January of 1967 the Internal Revenue Service rendered a ruling that the tax loss carryforward of Masters could be applied against future earnings of the merged company, if any.

By treating the 1,750,000 shares of common stock of Masters to be issued to Lady Rose as equity and the 1,750 shares of Masters preferred stock (convertible into 1,750,000 shares of common stock in 1973) as non-equity, under the plan the Biblowitzs, as stockholders of Lady Rose, would receive less than 80% of the common stock of Masters and there would be no reduction in the carryforward loss of Masters. Inclusion of the 1,750,000 shares of common stock after conversion would give the Biblowitzs 89.95% of the equity and would reduce the carryforward loss by approximately 50%. The issuance of the preferred stock had the effect of giving the Biblowitzs approximately 90% of the equity without reducing the carry-forward loss of Masters.

At the Board of Directors meetings of Masters on October 31 and November 7, 1966, certain directors stated, _inter alia_, that $1,600,000 representing 50% of Masters' tax loss carryforward should be added to the net worth figure of $1,600,000.

The carryforward loss of Masters was fully utilized by the merged company in the fiscal years 1968, 1969 and the

* means surviving company; viz. Masters.

first month of fiscal 1970; Masters saved, respectively, in taxes, $700,000, $1,148,500 and $56,500 for a total saving of $1,905,000.

(a) 5. Defendant Louis Biblowitz presented the proposed terms of merger to the Board of Directors of Masters on October 31, 1966. Louis Biblowitz told the Board of Directors of Masters in connection with the proposed merger of Lady Rose and Masters, <u>inter alia</u>, that:

(a) The earnings of Masters projected to January 31, 1967, would show, according to the opinion of the Secretary-Treasurer, a "break-even" or at best, a small profit.

(b) The after tax earnings of Lady Rose projected to January 31, 1967 was estimated to be $600,000.

(c) The Company has a carryforward loss of about $3,378,849 which the accountants for the Company have advised may be applied (subject to a ruling by the Internal Revenue Service) against the future earnings of the merged companies. Assuming that the pattern of performance of Lady Rose continues in the projected amount of $600,000 annual earnings, then the aforesaid carryforward loss would enable all earnings of the merged company to be after tax earnings, to the full extent of said loss.

(a) 6. The Board of Directors of Masters approved the plan of merger at an adjourned meeting on November 7, 1966 with one director, Herbert Kurtz, voting against the merger and stating:

> "I am in favor of the merger. My disagreement is only with the values that were reached as a basis for the merger. I think the merger will be good for the Company."

(a) 7. At the directors' meeting of Masters on October 31, 1966, several of the directors stated that it

appeared that the value of Masters was equal to or greater than that of Lady Rose and that the proposed issuance of 1,750,000 shares of common stock and 1,750 shares of preferred stock of Masters for all of the stock of Lady Rose should be reduced. These directors stated that to the net worth figure of some $1,600,000 for Masters, there should be added another $1,600,000 representing 50% of Masters' tax loss carryforward. Some of the directors stated that an opportunity should be had to ascertain whether any other company might be interested in purchasing Masters or merging with it. Louis Biblowitz advised the members of the Board of Directors that he had already made inquiries along these lines which had not proved in any way fruitful.

At the meeting of the Board of Directors of Masters on November 7, 1966, certain of the directors stated that less consideration than the number of shares proposed to be given by Masters in exchange for all the shares of Lady Rose should be issued and again raised the question of whether it would be in Masters' best interest to attempt to interest other companies in acquiring or merging with it.

On January 25, 1967 special tax counsel for Masters were orally advised pursuant to request for a ruling that a formal letter would be issued by the office of the Commissioner of Internal Revenue, which was received in February 1967, assuring the favorable tax treatment upon which the proposed merger had been predicated which included, inter alia, a ruling to the effect that the surviving corporation as a result of the merger, namely, Masters Inc., will be "entitled to carry-over as an offset what otherwise would be taxable income in future years, the full amount of the operating losses incurred by the present Masters Inc. during the past five years."

On January 26, 1967 the stockholders of Masters approved the plan of merger 370,315 18/27th shares in favor and 63,389 9/27ths shares against; plaintiffs voted against.

(a) 8. Masters did not have an independent appraisal made of its equity value or the equity value of Lady Rose.

(a) 9. Lady Rose did not have an independent appraisal made of its equity value or the equity value of Masters.

(a) 10. (a) Kalish and Rubinroit were the accountants for Lady Rose and Masters up through January 31, 1967; its annual fee was $25,000 from Masters and $15,000 from Lady Rose. After the merger Kalish & Rubinroit were the accountants for the merged company.

(b) Kalish & Rubinroit rendered professional services in the sale of the Miami, Florida, stores to Zayre in 1966, including observing inventory. Kalish & Rubinroit, in addition to its annual retainer, billed and was paid $25,000 by Masters in August, 1966; in addition, Kalish & Rubinroit billed and was paid $2,000 by Masters for the preparation of the financial statements included in the proxy statement relating to the merger with Lady Rose.

(c) Kalish & Rubinroit in May, 1967 billed and was paid by Lady Rose as a division of Masters $42,000 additional fees above retainer as agreed with the Biblowitzs for accounting services relating to periods prior to January 28, 1967.

(a) 11. The law firm of Flaum, Growman, Sassower, Rosenberg and Postel were special counsel for Lady Rose.

(a) 12. The defendants Biblowitzs consulted with the accounting firm of Kalish, Rubinroit & Co. since at least

April of 1966 on the terms of a possible merger between Masters and Lady Rose. In May of 1966, Kalish, Rubinroit & Co. prepared a confidential memorandum re proposal of plan of merger of Lady Rose and Masters in which Lady Rose was valued at $5,000,000 (based on ten times estimated net income of $500,000 for the 1967 fiscal year) and Masters was valued at $1,250,000 and based on the terms of merger proposed in that plan, the equity of the Biblowitz family in the merged company would be 79.68%.

(a) 13. The Lady Rose concessions in the Masters stores in the metropolitan area expired on January 31, 1967. The Lady Rose net income derived from operating those concessions was as follows:

		Before Tax	After Tax
	2/29/64	$86,754.59	$59,121.92
	2/28/65	101,850.26	67,971.88
	2/28/66	126,316.30	79,220.03
6 mos.	8/31/66	71,930.99	48,710.99

(a) 14. Under its concession from Masters, expiring January 31, 1967, Lady Rose's subsidiaries paid Masters at a rate of 8 1/2% of sales in excess of $474,117, plus $40,300 at its concessions in the Masters' stores in Flushing and Elmsford and at the Masters' Lake Success store 7 3/4% of gross sales plus $32,500.

In 1966 Rockower Bros. negotiated a renewal of its concessions in Masters' stores expiring December 31, 1966 and agreed to pay a fixed minimum plus a percentage of sales in excess of a dollar amount based on an effective rate of 10%, which was an increase over the existing rate of 8 1/2%.

The Rockower concession was renewed for a period of three years expiring on December 31, 1969.

(a) 15. By letter of May 23, 1966 Kalish, Rubinroit & Co. enclosed the confidential memorandum re a proposed plan of merger of Lady Rose and Masters to defendants Biblowitzs showing a value for Lady Rose of $5,000,000 and a value for Masters of $1,250,000.

Defendants Biblowitzs or their representatives delivered said confidential memorandum re a proposed proposal of plan of merger of Lady Rose Stores Inc. and Masters Inc. to Mr. Lawrence H. Rosenthal.

(a) 16. The 6% Series A and B Debentures of Masters in the amounts of $250,000 and $162,000, respectively, were subordinate to all sums due or to become due under the plan of arrangement and to future bank and other institutional loans obtained for operational purposes.

(a) 17. The Creditors Committee in August 1966 consented to the payment in full by Masters of the 6% Series A and B Debentures; at the time of the consent by the Creditors Committee, the amount of indebtedness under the plan of arrangement due within one year was $332,300 and after one year was $110,764.

(a) 18. On September 6, 1966, Mr. Jack Haizen was terminated as President of the Company. The Company purchased 44,668 shares of capital stock from Mr. Haizen for a purported consideration of $89,336.

(a) 19. Net concession income received by Masters (including discontinued operations) was as follows:

May 1, 1965 - $1,025,254

(9 mos.) Jan. 29, 1966 - $625,927

(a) 20. Masters at the time of the Board of Directors meeting on October 31, 1966 had the following named directors:

Louis Biblowitz, Chairman of the Board
Max Biblowit
Joshua Biblowitz
Arnold Ginsburg
Herbert Kurtz
Herbert Abramson
Ralph J. Weiner
Harry Gunther
Harry L. Lewis
Pincus Peterseil

Louis Biblowitz, Max Biblowit and Joshua Biblowitz were also the directors of Lady Rose Stores Inc. and with Joel Biblowitz, the son of Louis Biblowitz, owned all of the outstanding shares of Lady Rose Stores Inc.

Herbert Abramson was the President of Samuel Scheller & Co. Inc. which was a licensed insurance brokerage firm which acted as the insurance broker for Masters and Lady Rose.

Harry L. Lewis and his wife were the owners of the land and buildings in Elmsford, New York, tenanted by Masters.

Messrs. Ginsburg, Peterseil and Weiner or companies with which they were affiliated were vendors to Lady Rose.

Herbert Kurtz was the vice president of Rockower Bros. Inc. whose wholly owned subsidiaries were operators of leased departments in Masters' stores.

The defendants Biblowitzs assumed control of Masters in 1963, controlled both Masters and Lady Rose prior to and at the time of the merger in 1967 and controlled Masters after the merger.

(a) 21.. The certified net income of Lady Rose (except for the six month period August 31, 1966 which was unaudited) was reported in the Proxy Statement as follows:

		Before Taxes	After Taxes
	2/29/64	$304,397.77	$205,397.77
	2/28/65	426,262.54	301,262.54
	2/28/66	679,977.03	451,977.03
6 mos.	8/31/66	483,991.10	331,491.10

(a) 22. The effective tax rate of Lady Rose was:

	2/29/64	-	32.5%
	2/28/65	-	29.3%
	2/28/66	-	33.5%
6 mos.	8/31/66	-	31.5%

(a) 23. Lady Rose in July of 1966 sold its inventory and fixtures in Masters' three Florida stores, in which it operated concessions, to Zayre Corp. and its subsidiaries. The net income of Lady Rose in the discontinued Masters' stores located in Florida was reported as follows:

		Before Tax	After Tax
	2/29/64	$11,676.89	$ 8,212.11
	2/28/65	35,076.77	27,379.33
	2/28/66	91,282.32	63,621.60
6 mos.	8/31/66	69,698.87	44,618.87

(a) 24. The net income of other discontinued operations of Lady Rose was reported as follows:

	Before Tax	After Tax
2/29/64	$20,754.09	$13,485.92
2/28/65	11,244.29	9,527.85
2/28/66	28,120.68	19,970.77
8/31/66	21,235.70	14,145.70

(a) 25. The net income of Lady Rose from the concessions it operated in the four stores of Masters in the metropolitan area was reported as follows:

		Before Tax	After Tax
	2/29/64	$ 86,754.59	$59,121.92
	2/28/65	101,850.26	67,971.88
	2/28/66	126,316.30	79,220.03
6 mos.	8/31/66	71,930.99	48,710.99

(a) 26. Compensation paid by Lady Rose to its officers was as follows:

	Louis Biblowitz President	Max Biblowit Vice President	Joshua Biblowitz Secretary-Treasurer
Fiscal 1964	$29,433.33	$29,433.33	$31,933.34
Fiscal 1965	36,800.00	36,800.00	42,700.00
Fiscal 1966	45,600.00	45,600.00	55,600.00

(a) 27. Lady Rose operated concessions in certain Masters' stores of ladies' soft goods and apparel items.

(a) Lady Rose had concessions in the three stores of Masters in its Miami Division which were sold to Zayre in July of 1966;

(b) Lady Rose sold its inventory and physical assets contained in said Miami based stores to Zayre in July of 1966 and discontinued operating its concessions in said stores.

(a) 28. (a) At the end of November 1962, Masters operated nine stores in four states. During the early part of the fiscal year ending April 30, 1963, Masters encountered financial difficulties which rendered it impossible for it to meet its obligations as they matured. As a consequence, on January 31,

1963, it filed a petition for a Plan of Arrangement pursuant to Chapter 11 of the Bankruptcy Laws. Masters operated under this Plan until April 1967.

142 A

(b) After the sale of the Miami stores in 1966, Masters was left with the following stores:

(i) West 48th Street, New York, New York

(ii) Route 9A, Elmsford

(iii) Lake Success Shopping Center

(iv) Main Street, Flushing

(a) 29. On or about December 27, 1963, pursuant to the Plan of Arrangement with Creditors a subordinated loan in the sum of $283,000 was made to Masters, by affiliated and non-affiliated persons, including certain concessionaires.

The subordinated loan provided that the lenders have the right to purchase shares of common stock of Masters as follows:

(i) Three shares of the common stock of Masters, par value, $1.00 per share, for every one dollar of loan extended at a price of $1.25 per share if purchased on or before December 27, 1966;

(ii) Three shares of the common stock of Masters, par value, $1.00 per share, for every one dollar of loan extended at a price of $2.00 per share if purchased on or before December 27, 1968;

(iii) Upon the exercise of the option, such portion of the sums loaned, together with accrued interest as is required, may be applied to any sums due the Company by reason of the exercise of said option.

(a) 30. The shareholders of Masters had no right to receive payment of the fair value of their shares of Masters in a statutory appraisal proceeding in the event they voted against the merger with Lady Rose.

Pre-Trial Order (Excerpt) - Amounts Reported On Books Of Company - Stipulated at Trial (TR 321-334)

(b) 16. The operating (loss) for the discontinued Florida division of Masters for the following periods was not disclosed in the Proxy Statement.

May 1, 1965	9 months Ended 1/29/66	3 months Ended 4/30/66	Year Ended 4/30/66	3 months Ended 7/30/66	6 months Ended 7/30/66
$(8,854)	$(158,702)	$(97,810)	$(256,512)	$(114,484)	$(212,294)

(b) 17. (a) The operating profit (loss) for the metropolitan area stores of Masters, which as of October 31, 1966 were the only continuing operations of Masters, was:

May 1, 1965	9 months Ended 1/29/66	3 months Ended 4/30/66	Year Ended 4/30/66	3 months Ended 7/30/66 (1)	6 months Ended 7/30/66 (2)
$40,848	$86,989	$(90,214)	$(3,225)	$73,376	$(16,838)

(1) As corrected, TR 328-9

(2) As corrected, TR 329-30

PRE-TRIAL ORDER - Facts Stipulated At Trial

(c) 3. Lady Rose sales and net income from its concessions in Masters' Florida stores and from its concessions in Masters' other stores ~~is~~ was reported as follows:

(000)

	11 Mos. to 1/28/67	Year to 2/28/66	Year to 2/28/65	Year to 2/29/64	Year to 2/28/63*
Consolidated					
Sales	$13,182	$13,125	$11,194	$8,177	$7,381
Gross Profit	4,363	4,099	3,385	2,559	2,455
Net Before Taxes	808	680	426	304	360
Net Income	527	452	301	205	229
Income From Masters Ex Florida					
Sales	$ 1,870	$ 2,095	$ 2,226	$1,745	$2,398
Gross Profit	613	633	641	500	724
Net Before Taxes	134	126	101	86	134
Net Income	84	79	68	60	81
Sales as % Con. Sales	14.2%	16.0%	19.9%	21.3%	32.5%
Net Inc. as % Con. N.I.	15.9%	17.5%	22.6%	29.3%	35.4%
Income from Masters Florida					
Sales	$665	$ 1,839	$ 1,256	$605	$301
Gross Profit	253	557	362	173	91
Net Before Taxes	66	91	35	12	7
Net Income	47	64	27	8	5
Sales as % Con. Sales	5.0%	14.0%	11.2%	7.4%	4.1%
Net Inc. as % Con. N.I.	8.9%	14.2%	9.0%	3.9%	2.2%
Income from Masters Combined					
Sales	$2,535	$ 3,934	$ 3,482	$2,350	$2,699
Gross Profit	866	1,190	1,003	673	815
Net Before Taxes	200	217	136	98	141
Net Income	131	143	95	68	86
Sales as % Con. Sales	19.2%	30.0%	31.1%	28.7%	36.6%
Net Inc. as % Con. N.I.	24.8%	31.7%	31.6%	33.2%	37.6%

*Qualified Audit

PROSPECTUS

145A

PX 135

230,571 Shares

MASTERS, INC.

Common Stock
(Par Value $1.00 Per Share)

Of the shares offered hereby 130,571 shares are being offered for the account of the Selling Shareholders named herein under the caption "Selling Shareholders" and the remainder are being offered for the account of the Company. The Company will receive no part of the proceeds of the 130,571 shares being offered for the account of the Selling Shareholders.

There has been no public market for the Common Stock of the Company prior to this offering. The price at which the shares are offered hereby has been determined by negotiation among the Company, the Selling Shareholders and the Underwriter.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	Underwriting Commissions and Expenses(1)	Proceeds to Company(2)	Proceeds to Selling Shareholders(2)
Per Share	$16.00	$1.43	$14.57	$14.57
Total (3)	Minimum $3,689,136 Maximum $4,089,136	Minimum $331,576.56 Maximum $365,576.56	Minimum $1,446,000 Maximum $1,812,000	$1,911,559.44

(1) Includes $347,576.56 ($1.36 per share) cash commission and an estimated $18,000 ($.07 per share) reimbursement of expenses of the Underwriter, based on the exercise by the Underwriter of his right to purchase an additional 25,000 shares as described below.

(2) Before deducting additional expenses payable by the Company and the Selling Shareholders, estimated at $49,494 and $20,000 respectively.

(3) The minimum amounts shown above are based on the assumption that the right of the Underwriter to purchase an additional 25,000 shares as described below will not be exercised and the maximum amounts on the assumption that such right will be exercised in full.

In order to cover over-allotments, if any, the Company has granted to L. M. Rosenthal & Company, Inc. (the "Underwriter") the right to purchase, at the same price as the initial 100,000 shares of Common Stock to be purchased from the Company, a maximum of 25,000 additional shares of Common Stock, which the Underwriter will offer hereby at the public offering price indicated above, if such right is exercised. Such right expires June 12, 1969. The Underwriter may realize substantial additional underwriting compensation which is not disclosed above (see "Over-Allotment Option" under the caption "Introductory Statement").

Pursuant to an Agreement dated April 9, 1968, officers and employees of the Underwriter purchased for investment on February 20, 1969 an aggregate of 55,000 shares from certain of the Selling Shareholders at a price of $10.50 per share (see the caption "Transactions with Management"). The officers and employees of the Underwriter may realize profits on sales of the 55,000 shares of Common Stock purchased by them in addition to underwriting commissions. The Company will be required to bear the expenses of post-effective amendments to cover the resale of such shares by such persons.

The Common Stock is offered by the Underwriter subject to prior sale and when, as and if issued, delivered and accepted by the Underwriter, and also subject to the approval of legal matters by counsel for the Underwriter and for the Company. Right is reserved by the Underwriter to reject orders in whole or in part. It is expected that certificates for the Common Stock offered hereby will be ready for delivery on or about May 20, 1969.

L. M. Rosenthal & Company, Inc.

The date of this Prospectus is May 13, 1969.

146A

230,571 Shares

Masters, Inc.

Common Stock
($1.00 Par Value)

Transfer Agent:
SECURITY NATIONAL BANK

Registrar:
FRANKLIN NATIONAL BANK

INTRODUCTORY STATEMENT

Masters, Inc. (the "Company") was organized as a New York corporation in 1937. Its present business is the result of a merger in 1967 between Lady Rose Stores, Inc. ("Lady Rose"), an operator of leased departments for the sale of ladies' and children's apparel which was founded in 1925, and Masters, Inc. which has been engaged in the operation of retail discount stores since its inception. Although it retains the corporate name of "Masters, Inc.", the Company is now controlled by members of the Biblowitz family who were formerly the principal shareholders and officers of Lady Rose and who assumed control of the Company in 1963. The Biblowitz family controlled both the Company and Lady Rose at the time of the merger in 1967 (See "Transactions with Management"). The Company operates four retail department stores in the Metropolitan New York City area, 20 leased departments in other stores and three separate shops for the sale of apparel items.

At the time of the merger of Lady Rose into the Company in 1967, all of the outstanding stock of Lady Rose was owned by members of the Biblowitz family. As a result of the merger, they received 494,261 shares of the Company's Common Stock, representing 81.5% of the then outstanding Common Stock, and 1,750 shares of the Company's 5% Convertible Preferred Stock, representing all of the stock of such class. The shares of Preferred Stock are convertible into an aggregate of 494,261 shares of Common Stock on and after February 1, 1973 and the holders of the Preferred Stock have entered into an agreement to convert such stock at such date.

Members of the Biblowitz family now own approximately 72.3% of the outstanding Common Stock of the Company. Upon completion of this offering they will own approximately 44.4% and, assuming conversion of the outstanding Preferred Stock owned by them, they would own 67.3% of the shares of such class.

In 1963, Masters, Inc. filed a petition for an arrangement pursuant to Chapter XI of the Bankruptcy Act. A Plan of Arrangement involving a change of management and control of the Company was accepted by its creditors and approved by the Court. The Company operated under this Plan until April 1967. (See "History and Business of the Company".)

In the past the Company has paid no dividends on its Preferred Stock or its Common Stock. Any future dividends will depend upon earnings, the financial condition of the Company and other factors.

The minimum aggregate annual rentals payable by the Company under its existing leases is $2,065,900 including all leases for properties which are not yet being utilized by the Company. Certain of the leases provide for additional payments based on a percentage of sales. In the fiscal year ended February 1, 1969 the Company paid $1,863,929 in lease rentals, of which $368,997 was attributable to additional payments in excess of the minimum rents.

MASTERS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

The following consolidated statements of income of Masters, Inc. and Subsidiaries for the five annual periods, have been examined by Kalish, Rubinroit & Co., independent certified public accountants, whose opinion thereon appears elsewhere in this Prospectus, and includes on a pooling of interests basis the operations of the Lady Rose division as set forth in Note 2 of the financial statements. The statements should be read in conjunction with the other consolidated financial statements and notes thereto included elsewhere in the Prospectus.

	Fiscal Years		Year Ended		
	1964-65	1965-66	January 28, 1967	January 27, 1968	February 1, 1969
Net sales	$25,522,300	$26,259,477	$26,017,921	$28,413,396	$35,202,575
Leased department rentals and other income	520,331	389,368	521,248	560,224	769,467
Total	26,042,631	26,649,345	26,539,169	28,973,620	35,972,042
Cost and expenses:					
Cost of goods sold and occupancy costs	21,347,060	21,566,883	21,355,598	22,506,430	27,501,547
Selling, buying and general and administrative costs	4,120,304	4,318,039	4,682,780	4,910,671	5,964,361
Interest on debentures, bank loans, etc.	59,944	84,419	45,335	54,535	—
Provision for doubtful accounts	994	3,252	7,938	6,684	762
	25,528,302	25,972,593	26,091,651	27,478,320	33,466,670
Operating income (excluding discontinued Miami Division)	514,329	676,752	447,518	1,495,300	2,505,372
Operating loss from discontinued Miami Division (c)	(8,854)	(256,512)	(212,294)	—	—
Income before provision for federal income taxes and extraordinary items	505,475	420,240	235,224	1,495,300	2,505,372
Provision for federal income taxes (Note 7)	125,000	228,000	280,400	716,753	1,286,500
Income or (loss) before extraordinary items	380,475	192,240	(45,176)	778,547	1,218,872
Extraordinary items:					
Elimination of federal income taxes due to loss carry forward (Note 7)	—	—	—	700,000	1,148,500
Loss on sale of assets of Miami Division (c)	—	—	(585,616)	—	—
Total extraordinary items	—	—	(585,616)	700,000	1,148,500
Net income or (loss)	$ 380,475	$ 192,240	$ (630,792)	$ 1,478,547	$ 2,367,372

Earnings per share (based upon the common shares outstanding after full conversion of the 5% preferred stock as referred to in Note 2):

Number of shares outstanding at end of period	1,128,723	1,131,265	1,101,525	1,100,000	1,101,694
Income or (loss) before extraordinary items	$ .34	$ .17	$ (.04)	$ .71	$1.11(e)
Extraordinary items	—	—	(.53)	.64	1.04(e)
Net income or (loss)	$ .34	$ .17	$ (.57)	$1.35	$2.15(e)

(a) Numerical notes refer to Notes to Financial Statements appearing elsewhere in this Prospectus.

(b) The foregoing consolidated statements of income for the pre-merger period (Note 2) have been presented as a pooling of interests and have combined the periods reflected below:

	Fiscal Years		Year Ended
	1964-65	1965-66*	January 28, 1967*
Masters, Inc.			
Fiscal year ended	May 1, 1965	April 30, 1966	January 28, 1967
Lady Rose Stores, Inc. and Subsidiaries			
Fiscal year or period ended	February 28, 1965	February 28, 1966	January 28, 1967**

* On January 29, 1966 in order to conform to its natural business cycle Masters, Inc. changed its accounting year to the 52-53 week period ending nearest to January 31st of each year. Operations for the three months ended April 30, 1966 have been combined with those for the nine months ended January 29, 1966 to reflect the twelve months ended for the 1965-66 fiscal year.

** Includes only the eleven months ended January 28, 1967. Income for the month of February 1967 was not significant.

(c) The Masters' Miami division was activated in 1962 and expanded to three stores in 1964. The assets and business of this division were sold in 1966 resulting in a loss on the sale of the store fixtures and equipment of $585,616. Net sales of the discontinued Miami division not reflected in the foregoing statements of income were: Fiscal year 1964-5—$7,001,986; fiscal year 1965-6—$8,258,676; year ended January 28, 1967—$3,474,946.

(d) No dividends have been declared during the above period.

(e) Fully diluted earnings per share assuming the exercise of the 10,000 options referred to in Note 8:

Income before extraordinary items	$1.10
Extraordinary items	1.04
Net income	$2.14

HISTORY AND BUSINESS OF THE COMPANY

Since the merger of Masters, Inc. and Lady Rose in 1967, the Company has operated as two closely allied and integrated divisions, the "Masters Division" and the "Lady Rose Division". The Masters Division has been operating as a retail distributor of a variety of hard and soft goods since 1937. The Lady Rose Division has been operating since 1925 as a retail distributor of ladies' and children's garments.

In January 1963, Masters, Inc. petitioned for an arrangement with its creditors under Chapter XI of the Bankruptcy Act. In April 1963, a group which included Lady Rose Stores, Inc. ("Lady Rose") purchased control of the Company from the Estate of Philip Masters, the founder of the Company, and from his descendants. At that time, Mr. Louis Biblowitz, the President of Lady Rose, became Chairman of the Board and Chief Executive Officer of the Company and the members of the Biblowitz family assumed control of the Board of Directors. The Company then negotiated and entered into a Plan of Arrangement with its creditors which was confirmed by the Court. The Company fulfilled all of its obligations under the Plan of Arrangement and in April 1967 the Plan was terminated so that the Company no longer operates under Chapter XI.

In 1966 the Company sold three stores which it had been operating in Florida at a loss. Two of these stores had been opened in 1964 and the third had been opened in 1962.

Sales of the Lady Rose Division in the Company's fiscal year ended February 1, 1969 accounted for approximately 61% of its total sales. The profitable operations reflected in the consolidated statements of income result primarily from the inclusion on a pooling of interests basis of the profits of the Lady Rose Division.

Operations of Masters Division

The Company's Masters Division operates four discount stores known as "Masters" and located in the Metropolitan New York City area. The stores are all of the self-service type popularly known as "discount stores" and sell a wide variety of merchandise, including major appliances such as refrigerators, freezers, television sets, radios and phonographs, and housewares, luggage, cosmetics, toiletries, giftware and photographic equipment. The Division itself does not sell apparel or other soft line goods, although certain of these items are sold by operators of lease departments in the Masters stores. The Company's policy is to sell nationally advertised and other brand name merchandise at a low markup. Sales are for cash only except that the Company honors several credit plans under which the Company receives payment within thirty days for vouchers submitted to the operators of the plan. The costs of such plans range between 2½% and 3% of the total charge sales. No deliveries are made with the exception of major appliances and other bulky items. Generally, seconds, irregulars, factory rejects or similar merchandise is not sold.

The Company purchases its merchandise principally from wholesale distributors although it also purchases some items directly from the manufacturers. No more than 2% of the sales of the Masters Division are derived from products sold under Masters private brands.

Major appliances accounted for approximately 25.5%, 21.4% and 18.9% of the total sales of the Masters Division during the Company's 1967, 1968 and 1969 fiscal years. No other single area of the Division's sales accounted for more than 9.6% of such sales during those years.

EXHIBIT
U. S. DIST. COURT
S. D. OF N. Y.

141 id

150A

masters

Incorporated

135-21 38th Avenue
Flushing, N. Y. 11354
Tel. 359-5700 (Code 212)

August 24, 1966

TO OUR SHAREHOLDERS:

We enclose herewith the financial statements of your Company for the period ended January 29, 1966. It is to be noted that this is a short fiscal period running from May 1, 1965 to January 29, 1966. Hereafter, the annual fiscal period of the Company will be from February 1st of each year to January 31st of the following year.

Because the area of control over our three Miami stores was limited by the distance between our executive offices and those locations, your Board decided, with the approval of the Creditors Committee, that it would be in the best interests of the Company to sell those stores, since we had received several proposals to do so.

As a result, in July of this year that sale was consummated. No doubt you are fully aware of this by reason of the write-ups appearing in various news media.

As a consequence, your Company today is in a good working capital position.

We wish also to report that all payments called for under the Plan of Arrangement with creditors have been met promptly so that, at the present time, the remaining indebtedness to creditors is in the approximate amount of $400,000.00. This will be liquidated within the course of the next fifteen months.

Continued effort has been made to improve our administrative systems. We now have installed and in operation automated equipment which has improved our inventory and merchandise controls. Your officers continue to have as their goal the limitation of operating costs with simultaneous strong efforts to increase the volume of sales of the Company.

Your Company's efforts in the future, we anticipate, will enable the Company to continue to stabilize its position in the merchandising field.

Respectfully submitted,

MASTERS INC.

Louis Biblowitz

LOUIS BIBLOWITZ
Chairman of the Board

LB/mb
ENCL.

PX 153

151 A

A P P R A I S A L

OF THE

FAIR VALUE OF MASTERS AND OF LADY ROSE

SECURITIES IN CONNECTION WITH THE MERGER

OF LADY ROSE INTO MASTERS

LEONARD MARX, JR.

TABLE OF CONTENTS

QUALIFICATIONS OF LEONARD MARX, JR.

business address: 415 Madison Avenue, New York, N.Y. (21st floor)

home address: Orienta Point, Mamaroneck, N.Y.

education: B.A. Yale University 1954
M.B.A. Harvard Graduate School of Business Administratic
1956

military: Comptroller's office 1st Army Headquarters 1956 - 1958
Governor's Island

business: Vice-President New York Securities specializing in real estate related securities.

director: Retail Properties, Ltd.,Montreal, Canada

Specialty Restaurants, Long Beach, California

Merchants National Properties, New York City

Florida Palm-Aire (FPA Corp.) Pompano Beach, Florida

member: New York Society Security Analysts

President 1970-71 Real Estate Analysts Group

speaker: A.M.R. seminars, NYSSA luncheon programs, Financial Analysts Annual Convention.

research reports 1965-66:
E. J. Korvette
Caldor
Morse Shoe
Volume Merchandise
Edison Shoe
Rockower Brothers
Grand Union
Bohack
Great A & P

Continuing actively as research analyst, full time, from 1965 to date.

SUMMARY

I believe that an independent Board of Directors of Masters would have insisted on and obtained a 50% interest in the merged companies. However, to be conservative I have placed a value of $3 million on Masters and $3.35 million on Lady Rose. The $3.35 million valuation of Lady Rose includes its 15.1% interest in Masters at its book cost of $80,000 (this excludes the $80,000 in subordinated convertible notes which were deemed fully paid upon the merger.) In the table below I have increased the valuation of Lady Rose by $370,000 which is the difference between its bock cost for the Masters stock and my appraised value of its interest in Masters. In my opinion a final figure of 38% for the public shareholders of Masters would have been acceptable to Lady Rose and the merger would have been consummated on those terms.

Valuation Masters	$3,000,000	Valuation Lady Rose	$3,350,000
-15.1% owned by Lady Rose	-450,000	+ market value of Masters' holdings in excess of cost	+370,000
	$2,550,000		$3,720,000
Total:	$6,720,000		
Masters public shareholders	2,550,000		
	38%		

The appraisal is made as of November 15, 1966, the date of the merger agreement between the parties.

EVALUATION OF LADY ROSE STORES, INC.

In November 1966 Lady Rose had 275 fulltime employees operating 21 retail ladies wear units of which 4 were individual stores and the rest were leased departments in discount department stores with the following landlords:

3 - Masters
2 - Whites
3 - Bargaintown USA
5 - Billy Blake
3 - Times Square

The units were all in the metropolitan New York area (except for 2 Puerto Rican locations which were low volume units that did not contribute to profits). While Lady Rose had a reputation as a good operator, it was not in any units operated by the major discount department store chains. Lady Rose was privately owned, so that there was no market evaluation of the common stock. Based on the income statement for the 4 fiscal years ending February 28, 1963 through 1966, Lady Rose's operations are comparable with other leased department operators who were publicly owned:

company	Units	Revenues (000,000)	Annual growth	Net income/ Sales	Net income/ Equity
American Snacks	#195	$ 9.2	16%	4.2%	32%
Barbara Lynn (ladies wear)	66	26.7	50	3.4	23
Daylin Drug (pre DISCO acq.)	125	36.	70	3.2	24
Hardlines	118	32.3	13	3.7	26
Gateway Sporting Goods	370	37.3	20	2.	13
Gilbert Shoe	78	12.3	22	2.2	19
Holly Shops (pre Kressge acq.)	170	48.	25	3.	10
LADY ROSE	21	13.1	17	3.4	18
Marrud Drug	306	78.2	-	def	def
Morse Shoe	468	91.7	14	5.8	23
Morton Shoe	140	28.6	5	3.2	20
Rockower men's wear	43	15.	20	3.	19
Spencer Shoe	119	23.		1.5	7
Unishops mens wear	200	68.	15	5.2	31
Volume Merchandise ladies wear	234	48.6	29	2.6	16

By the fall of 1966 most of the better managed larger ladies ready-to-wear chains (with the exception of Lerner Shops and Petrie Stores) had realized that they could not compete for choice locations in shopping centers, and that their future was as a leased department or operator of a discount department store chain. Over the years the discount stores with good management were gradually absorbing their leased departments either by acquisition or more often just by not renewing the short-term leases and operating more departments themselves. Zayre's was originally a retail store operator and phased out its Bell Shops and Nugents units as it opened more of its own department stores. Similarly Gaylord's curtailed its Betty Gay units and concentrated on its Gaylord's department stores, so that by the summer of 1966 it had 30 Betty Gay units accounting for 22% of sales and 11 discount department stores accounting for 77.8% of sales. Similarly Franklin Shops with its Barker discount stores, Mangel's with its Shopper's Fair. Diana Stores still had 230 retail specialty shops, but 80% of its $137 million volume came from its Miller, Great Eastern, and Gulf Mart discount department stores. Virginia Dare had almost all its $96 million volume from its Atlantic Mills discount stores and few of its specialty stores remained. The old line variety chains were embarked on a similar course: Neisner with its Big N; Fishman with Masons; and Kressge with K-Mart. As were the supermarkets: Food Fair with J. M. Fields; Stop & Shop with Bradlees; Cook Coffee (Pic-n-Pay) with Ontario and Uncle Bills; Borman Foods with Yankee; Grand Union with Grandway; and Lucky with GEMCO.

The new retailing chains which were built rapidly with leased department locations saw the handwriting on the wall and were trying to acquire their own department stores which they could operate and control the lessees. Unishops, Barbara Lynn, and Spencer Shoe were among the

lessees who followed this course. Others such as Gilbert Shoe were trying to attain an identity and unit of their own with free-standing highway stores and had 10 of these units as well as 66 leased shoe departments, similar to what Melville (Thom McAn) and the Kinney division of Woolworth were doing. Morse Shoe had not yet started to look for free-standing or shopping center locations, but it was pretty well known that its largest landlord, Zayre's - would operate its own shoe departments when the Morse leases expired. These were the reasons why these stocks sold at such low multiples of earnings and book value even though they had exhibited above average growth during the past few years. Morse for example had increased revenues during the past decade from $8.8 million to $91.7 million, and net earnings had increased every year from $80,000 in 1957 to $5.3 million in 1966. Yet the stock sold at 8 times earnings in late 1966 and the average price/earnings multiple during the 1963 - 1966 period was not much over 8 times according to the Value Line Investment Survey. Standard & Poors shows a range of 5 - 11 times earnings during this period for Morse.

Comparative Statistics 1966 (000,000 omitted)

company	Pre-tax net	equity	revenues	Market Value	Price/ Earnings	Market/ book
American Snacks	$ .53	$1.22	$ 9.2	-- privately held --		
Barbara Lynn	1.23	3.84	26.7	$ 5.	6x	1.2x
Daylin Drug	1.7	4.2	36.	11.	10	2.7
Gateway	1.38	6.34	37.3	9.	9	1.5
Gilbert Shoe	.4	1.42	12.3	1.8	7	1.2
Hardlines	2.1	4.75	32.3	8.	7	1.7
Holly Shops (1964)	1.8	4.7	48.	11.2	8	2.4
LADY ROSE	.7	2.5	13.1	-- privately held --		
Marrud (Chapter XI)	-5.94	1.4	78.2	1.8	-	1.3
Morse Shoe	7.94	19.	91.7	43.	8	2.3
Morton Shoe	1.75	4.5	28.6	8.	8	1.7
Rockower	.8	2.5	17.	4.5	10	1.8
Spencer Shoe	.51	4.6	23.	4.	11	.9
Unishops	5.6	11.4	68.	22.	8	1.9
Volume Merchandise	1.8	7.	48.6	9.	7	1.3

Lady Rose is the smallest and least geographically diversified of the companies in the above table. Since its growth rate and return on invested capital is equal to the better companies we would use a multiple of 7 times earnings, which would give a valuation of $3.2 million based on fiscal 1966 earnings, or $3.7 million based on estimated fiscal 1967 earnings (year ending February 28, 1967 on which we have used $550,000 after tax net). This would be 1.3 - 1.5 times book value which compares with the numbers shown on the above table.

I have analyzed a number of other statistics such as working capital, total assets, inventory turns, revenues per share, etc. but have found that the only common denominator appears to be net after tax earnings per share. This is because at that time all the companies were enjoying "normal" profit margins. Where a company's margins were depressed (i.e. Marrud) the market then looked at the leverage -- the amount of revenues controlled and actual book value adjusted for inventory revaluations.

The other test besides market prices of the stocks of related companies is to study mergers and acquisitions of related companies during this period. While many companies were anxious to buy discount department stores, there were few acquisitions of lessees or specialty store operators. Volume Merchandise acquired some such as Retail Jenny Shops -- but these were at less than book values. Kresge acquired its sporting goods lessee Dunham for 19,464 shares worth $1.1 million in December 1965, and its ladies wear lessee Holly Shops in December 1964.

At the time of the merger Holly operated 75 retail stores and 95 leased departments of which 46 were in Kresge's K-Mart units. Holly's sales had climbed from $16.2 million in 1960 to $52 million for the 12

months ending October 1964. Earnings had been more erratic, but had more than doubled to $811,000 for the fiscal year ending January 31, 1963. For the 9 months ending October 1964 net earnings were $980,000 vs $198,000 the previous year. Holly had working capital of $3.8 million, CBH assets of $11 million and only $~~.5~~ .900 million in debt. Kressge acquired Holly for 238,165 shares which had a market value of $11,194,000.

Kressge exchanged 4 of its shares for each 8.5 shares of Holly held by the public, and 4 shares for each 9.6 shares of Holly held by its board chairman and major stockholder, George Goodfriend. So the major insider got 12% less than the public.

Kressge bought Holly after carefully studying the firm and working with it in the K-Marts. Kressge was just beginning to expand its K-Mart operations and wanted to acquire merchandising managements that could grow internally with K-Mart and offer it the skills in fields which the variety chain had historically not been in. Note also that Duff, Anderson & Clark were retained to evaluate the fairness of the Kressge-Holly merger and had never worked for either party previously.

Woolworth took a different approach in its Woolco units so that instead of acquiring Rockower it brought Richman Brothers in as another lessee since Rockower could not expand fast enough to handle all the Woolco Units and Woolworth wanted to be able to compare two operators.

In July 1966 Zayre's acquired Hardline Distributors which operated 82 leased departments in Zayre's units and 36 departments in other discount chains, including Gaylords, Diana, Shoppers World in Rhode Island and Masons. Zayre's had notified Hardline in 1966 that they would

not renew the leases in 1970. The Hardline proxy statement issued in July, 1966 for the merger of Hardline into Zayre stated:

> "The management of the Company gave particular consideration to the fact that ... Zayre had indicated that these leases would not be renewed after the expiration in January 1970."

Zayre's issued 463,636 shares of preferred stock paying a 75¢ dividend which was convertible into .375 shares of Zayres, plus $850,000 in cash. The major stockholders of Hardline who held 400,000 of the 700,000 shares outstanding received .41 shares of Zayre preferred and $2.12 in cash for each share of Hardline -- and did not receive the initial $1.00 of dividends, plus they picked up about $30,000 in expenses connected with the acquisition. The public shareholders received one share of Zayre preferred for each Hardline share. Allowing for a premium on the preferred over its conversion value, the merger had a value of $8 million. Hardline had a book value of $4.75 million, working capital of $4.8 million, assets of $9.1 million, and debt of only $.6 million. The price was 6.7 times earnings with the following record:

Hardline Distributors (000,000 omitted)

year ending	1-63	1-64	1-65	1-66
Sales	$19.42	$24.28	$28.76	$32.27
Pre-Tax	.48	1.16	1.90	2.09
Net Income	.29	.94	1.10	1.20
# of units (end of year)	#86	102	104	114

Lastly the analyst would go behind the reported numbers for Lady Rose to see if any adjustments were needed, particularly for events that

had transpired since the end of the fiscal year and hence would be omitted from the audit. In July 1966 Zayre purchased the 3 Miami stores of Masters and terminated Lady Rose's leased departments in these 3 units. That kind of risk explains why the stock market was reluctant to place a normal price-earnings multiple on this type of operation. On termination of its Florida leases, Lady Rose did not receive a premium over its book cost of its inventory and fixtures. Since Lady Rose did not have an active expansion program where it had executed leases for new locations to replace those units, I believe this volume should be deleted in estimating Lady Rose's fiscal 1967 (and future years) volume, profits, and growth potential.

Lady Rose Income Statement (000 omitted)

	2-28-63	2-29-64	2-28-65	2-28-66
reported sales	$7,381	$8,177	$11,194	$13,182
- 3 Miami units	-301	605	1,256	-1,839
recurring sales	7,080	7,572	9,938	11,343
gross profit	$2,455	$2,559	$ 3,385	$ 4,099
- 3 Miami units	-91	-173	-362	-557
recurring g.p.	2,364	2,386	3,023	3,542
net income	$ 229	$ 205	$ 301	$ 452
- 3 Miami units	-5	-8	-27	-64
	224	197	274	388

The projections for the fiscal year ending in early 1967 that we used were for about a $100,000 increase in net. Eliminating the $45,000 in net income from the Miami units which had been sold prior to November 1966, I would use a projected net income of $500,000* which

* Unaudited quarterly and semi-annual figures normally have little significance in the retailing field.

would reduce my maximum valuation to $3.5 million for Lady Rose. Furthermore, the leases in the Masters stores expired in January 1967. The Elmsford and Flushing units were two of Lady Rose's best departments with revenues of $746,000 and $919,000 and with pre-tax margins of 7%.

Lady Rose was paying Masters 8.5% of sales as rent, yet for the other larger operators that we studied the average rent was 10-11%:

Average 1966 occupancy costs

Barbara Lynn	10.4%
Gilbert Shoe	10.6%
Morse Shoe	11. %
Morton Shoe	11. %
Volume Merchandise	10+ %
Marrud	10. %
Rockower	11. %

Rockower leases for the men's wear departments in Masters had recently been renewed at 10%. In my opinion Lady Rose would have paid 1.5-2% higher to renew the leases, which on $2 - 2.1 million of volume would be $30-40,000 per year added rent. Based on Lady Rose's historic 33% federal income tax rate, this would be a minimum of $20,000 after taxes. Thus our adjusted net income for Lady Rose would be $365,000 in fiscal year 1966 and a projected $480,000 in fiscal year 1967. Based on a maximum price-earnings multiple of 7 this would give a value of $3.35 million. I think this is a generous multiple in view of the size of the company and its very limited marketability in addition to the other factors considered above.

EVALUATION OF MASTERS, INC.

In November 1966 Masters operated 4 discount department stores with 196,700 square feet of space doing an annual volume of $18 million, or $92/sq.ft. of total area and $120/sq.ft. of selling area:

location	lease expiration	square feet sales	square feet total	sales (000)	rent (000)	rent cost
Manhattan, W 48th between 5th and 6th Aves	4-72	17,210	22,913	$3,835	$75.6	2.0%
Westchester, route 9A Elmsford	10-73	49,525	62,100	5,233	94.8	1.8%
Lake Success - New Hyde Park, Union Turnpike	2-74	38,965	54,300	4,273	97.4	2.3%
Flushing, Main St.	1-77	46,350	57,400	4,676	64.8	1.4%

The stores were all in the New York metropolitan area where Masters was the original discount operator since before World War II and had a well known name and good consumer acceptance. Advertising expenditures of $650,000 covered all the units and ads in one paper (The Daily News) reached the majority of the trade area. Central office expenditures of $500,000 were adequate since all the units could be easily reached by car in a day for supervision. Volume per foot compared most favorably with other discount department stores, and the rental costs were also very favorable compared with other chains. In the fiscal year ending May 1, 1965 Masters was operating 7 units with a volume of $30 million and had a pre-tax profit of $79,212. In fiscal 1966 on the same volume a loss of $259,737 was reported with the same units. The 3 Miami units were sold to Zayre's in July 1966 for $1,897,816 cash. These units had lost $8,354 in fiscal 1965 and lost $256,515 in fiscal 1966. By eliminating the revenues and loss of these units Masters would have shown a ~~profit~~ loss of $3,222 in fiscal 1966 instead of a loss of $259,000, ~~instead of a loss~~. In the 3 month period ending July 30 1966 Masters showed a loss of $45,424 vs a loss of $150,626 for the same period of the previous year. The 3 Miami units

CBM

had an operating loss of $114,484. Subtracting this loss meant the remaining 4 NY stores had a profit of ~~$69,000.~~ $73,376. Since these were the last figures available at the time I would conclude that the remaining Masters units would at least break even for the fiscal year. I cannot accept this breakeven as being indicative of what the management (who were highly regarded merchants) could do with these 4 units under regular operating conditions: for example, net sales in operated departments were $12,836,000 with a cost of goods sold of $10,404,000 or 81%. The normal margin would range from a low of 71% for King's department stores to a high of 76% for Arlens, Times Square, Giant, and Zayres et al. The reduction in 5% would increase pre-tax profits by $640,000. CBM

Income from leased departments was $499,500 on sales of $5,182,000 or 9.65%. This should run 11% based on experience of other discount chains. For the 4 previous fiscal years Masters income from lessees had been much higher, which causes me to believe the numbers furnished showed income from this category $100,000 below what could be expected:

Fiscal year	Leased Department Sales (000)	Rental and other income	percentage
1963	$8,136	$ 834	~~10.2%~~ 9.3
1964	7,127	846	~~11.9~~ 9.
1965	8,330	1,072	~~12.9~~ 8.8
1966	8,624	1,076	~~12.5~~ 9.4
1967 est.	5,182	500	9.6

CBM

~~Three~~ Two of the concessionaires had either renewed or entered into leases that increased percentage rents to Masters to take affect in the next fiscal year: Perry's Shoes, ~~Terril Stationery~~, and Rockower men's and boys wear. Rockower increased its percentage from 8.5% to 10%, which is CBM CBM

particularly important since Herbert Kurtz, the #2 man at Rockower Brothers served on the Masters' Board of Directors.

I feel that the elimination of the Miami units, change in management, renegotiation of leased department leases, and strong financial condition of Masters after the Miami sale and cash received from Zayre's, indicates at least a breakeven operation currently, and a projection of at least $400,000 pre-tax once these changes took effect. Thus Masters numbers would be as follows:

$18	million	revenues
.4	"	projected pre-tax
1.8	"	working capital
1.7	"	stockholders' equity
.4	"	long-term debt

Comparison of Masters With Other Discount Operators:

company	revenues (000,000)	working capital/ revenues	shareholders equity/revenues	Pre-tax Margins
Arlens	$200	12%	11%	4.%
Atlantic Mills	135	8	10	2.
Caldor	70	9.2	10	5.
Clarkins	21	2	2	2.5
Community Discount	43	5	13	3.
Family Bargain	29	9.5	12	5.7
Fed Mart	95	7.6	10	1.
Gaylords	45	7	8	3.6
Interstate	505	8	12	3.5
Kings	110	11	18	6.
Korvette	780	6	9.2	2.
S. Klein	166	5	5	.6
Mamouth Mart	36	9	12	5.7
MASTERS	18	10	10	0-2.
Miracle Mart	42	def	def	def
Nat. Bellas Hess	178	7	6	2.
Shoppers City	35	1.6	3	3.5
Vornado	334	9.3	15	4.3
Zayres	347	10	10	4.2
Floyd Bennett	35	def	3	def.

The above indicates that Masters was now adequately capitalized, on the basis of working capital to revenues and shareholders' equity to revenues. The working capital did not decline by the sale of the 3 Miami stores, yet there was a decrease in revenues by one-third and a decrease in number of units from 7 to 4.

The table below relates the market values of the outstanding shares for publicly traded discount department store chains, and the acquisition value where the company was acquired by another chain:

Table of Comparative Figures for Discount Chains
(000,000)

company	market or acquisition value	revenues	net income	book value	growth rate	net earnings/ equity
Atlantic Mills	21.	135	1.8	13.6	0%	14%
Shoppers World	4.5		.4	.8		50
DISCO	2.		.14	.1		
Floyd Bennett	2.	35	-.3	.9	0	def
G.E.S.	2.1	25	.27	.84	15	32
Charles	1.1					
Ontario	3.5	30	.4	1.23		30
Shoppers City	4.5	35	.4	1.02		40
Miami Masters	1.9	12	-.26	2.4		def
Town & Country	.63	5	.07	.16		44
Gulf-Mart	2.1	18	.2	1.13		18
Great Eastern	4.6	25	.2	2.17		
Clarkins	2.4	21	.3	.37	8	80
MASTERS		18	.25	1.7	0	d-14
Caldor	30.	70	1.6	7.	35	21
Family Bargain	-	29	.9	3.4	5	27
Fed Mart	10	95	.4	10.	13	4-10
Gaylords	7	45	1.	3.7	15	27
Kings	40	108	4.1	19.	15	22
Korvette	100	780	8.	72.	-	15-8
S. Klein	10	166	.7	8.3	10	d-9
Mamouth Mart		36	1.	4.4	30	30
Nat. Bellas Hess	15	178	1.8	11.	9	d-16
Twin Fair	13	28	1.4	5.6		28
Zayres	90	347	8.	36	20	22

The following acquisitions or mergers were analyzed:

1. Spartans acquired Virginia Dare which operated 49 Atlantic Mills discount department stores and 14 conventional ladies wear stores. The terms (prospectus dated 12/17/65) were $19,156,000 of Spartan 5% convertible debentures which were convertible at any time at $38 per share which was the market price of Spartans at that time. Assuming a 10% premium for the conversion value, the deal was worth $21 million which was 155% of Virginia Dare's book value of $13.6 million, and 11.5 times net earnings of $1,826,000. While Virginia Dare had grown rapidly and had sales of $135 million ($96 million net of leased departments) profits had been erratic and 1965 net was just equal to that of 1961, so that margins had been declining to 3% pre-tax on net sales and 2.2% on gross sales (just what I projected for Masters). The price was 16% of the annual revenues controlled.

2. Alden in Chicago acquired the Greatway Corporation which operated 7 Shoppers World stores and had plans for 4 more (proxy dated 3-7-61) for preferred stock convertible into 80,000 Alden shares which gave a value of $4.5 million to Greatway. The Company had net income of $368,000 (12 price/earnings); $821,000 book value (5.5 times book); revenues of $19 million (24% of revenues); total assets of $2,962,000. Alden was buying the management and future growth potential.

3. Daylin acquired the 7 DISCO department stores (agreement signed 6-14-65) for 57,143 shares valued at $722,000, plus they agreed to loan DISCO $1,286,000 for 20 years since the company was overextended and had a total book value of $84,000. The price was 8.5 times book and 5.5 to 15 times earnings depending upon whether you add the 20 year subordinated loan to the shares in determining how much was paid for $133,000 of income.

4. Spencer Shoe acquired the 9 Floyd Bennett units in the New York Area (proxy dated 9-9-65) for 16,078 shares of $100 par 2% preferred convertible at $8.25. Floyd Bennett had net revenues of $16 million, book value of $912,000, and assets of $5,743,000. However the company was in trouble due to weak management and expensive expansion and had lost $288,000 in fiscal 1965. Working capital was a minus $1,016,000. The stock which traded over the counter had dropped from 10 to 4 prior to the merger but was still selling at 2 times book which the market valued at $2 million. Spencer was willing to pay this price in hopes of turning around a loser because of the leverage in being able to control over $35 million in sales. For the first 22 weeks of 1965 ending June 5, 1965 Floyd Bennett lost ~~$37,000~~ against a loss of $141,000 the previous year. Spencer was taking a significant risk in that by assuming Bennett's debts of $2.1 million plus its current liabilities, the entire Spencer Shoe operation could be dragged under since it had a shareholders equity of only $4 million.

$237,000

5. Bargaintown U.S.A. acquired the 3 G.E.S. closed membership discount stores for $2,100,000 cash as of February 14, 1965. The stores had total revenues of $25 million, and since they were mainly leased departments, net revenues of $3 million to GES. The price was 9% of total revenues. Net income was $266,000 (8 times earnings) and no new units were under construction. Book value was $838,000 (2.5 times book) and working capital $168,000. All the units were leased and total assets were $1,482,000. This was an all cash transaction financed by a subsequent convertible debenture issue by the parent.

6. United Whelan sold 2 of its Charles discount department stores to Kings in November 1965 for $1,077,380 in cash. These were the 70,000 sq. ft. Raleigh and 87,000 sq. ft. Winston-Salem, North Carolina units. Thus Kings paid $7.00/sq. ft. or 12% of estimated sales to acquire the assignment of leases for these units.

7. Cook Coffee (Pic-N-Pay chain) acquired the 9 Ontario Discount department stores on October 8, 1964 for 110,000 shares worth $3.5 million (90,000 were contingent upon earnings). Cook was already in the business with the smaller Uncle Bill's discount units. Ontario had revenues of $22 million in 1963 and anticipated revenues of over $30 million in 1964 (price 14% of revenues). Earnings were $404,000 after taxes at a full 50% rate (8.6 times earnings). Book value was $1,230,000 (price 3 times book), assets $5,090,000. and debt $930,000 which we add to price paid in determining percentage of price to total revenues.

8. Zayres agreed to acquire the 4 Shoppers City stores in late 1966 for 129,350 shares worth $4.5 million. These units had gross revenues of $35 million and net revenues of $25 million (price 13% of gross revenues). They earned $391,000 after taxes (price 11.5 times earnings). Book value was $1,018,000 (price 4.5 times book) Working capital $620,000 and debt $1,629,000. Assets $5,334,000. It had a very high average volume per unit of $9 million and 38% return on equity.

9. Zayres acquired the 3 Miami units of Masters in July 1966 for $1,897,816 all cash. Zayres was already in the Miami market and could absorb some of its overhead and advertising burden with these additional units. The North and South Miami units were each 100,000 sq. ft. stores opened in 1964. The Central Plaza store had been opened earlier. These units had revenues of about $12 million (price 16% of revenues) and we can assume from the Zayre acquisition all they lacked was proper management since Zayre was paying cash for units that lost $256,512 for the year ending 4/30/66 and had not shown a profit in any of the previous years. The price was 77% of book value.

10. In September 1961 Lane Bryant who was then a leading ladies ready to wear chain doing \$80 million volume decided to enter the discount department store business by acquiring Town & Country Distributors, of which Herbert Clayton was the sole stockholder. The price was 20,000 shares of stock worth \$630,000. of which 5,000 were escrowed for up to 5 years based on future profit projections being met.

    For the year ending July 1, 1961 Town & Country had sales of \$4.2 million (price 13% of sales) and profits after taxes at a 34% tax rate of \$70,600..(9 times earnings). It operated 5 stores in Lewistown, Chambersburg, Altoona, Lancaster and Sunbury, Pennsylvania. Three of these units had opened in September 1960, so that at the time of the acquisition sales were running at the rate of \$5 million yearly. Book value was \$158,600. (price 5 times book). Like Masters the units were all in one trading area. By 1966 Lane Bryant had become less enthusiastic about the discount store business as competition came into the trading area, and Town & Country's activities were severly curtailed.

    Since Lane Bryant was listed on the New York Stock Exchange in 1961, there were 1,266,075 shares outstanding so the 15,000 free shares paid to Mr. Clayton could be easily sold, and the stock was immediately registered (1961 listing application #A-19940), I conclude that the stock was at least equal to cash in value particularly since the recipient could keep his low basis on the T & C stock cost on his Lane Bryant shares.

11. At the same time in 1961 Diana Stores, a lower priced ladies wear chain with revenues of \$50 million and a trend of declining earnings, made 2 similar acquisitions. The 322,500 shares issued were listed on the New York Stock Exchange shortly thereafter (listing application A-20096 December 7, 1961). We do not consider the shares readily marketable since only 880,356 shares of Diana were then issued.These acquisitions, while made 5 years prior to Masters, are quite interesti to analyze since with Great Eastern, Diana was buying chiefly management, and with Tex-Mart existing stores, rather than management to build and run future units:

    a. Tex-Mart was acquired for 101,500 shares of Diana stock with a market value of \$2.1 million. IN addition Diana agreed to pay additional consideration of up to 60,000 shares, based on 12 times the net earnings for calendar year 1962 in excess of \$250,000. (i.e. 15,000 shares for the 1st \$250,000 of net in excess of \$250,000) It was not expected this would be earned so we are making the same assumption.

       Tex-Mart operated a 42,000 sq.ft. selling area "Gulf-Mart" store in San Antonio with 650 car parking that opened in 1959 and had sales of \$9,240,000 and net profits after 50% tax rate of \$132,490. A similar 45,000 sq. ft. store with parking for 650 cars opened in Austin the month after the Diana acquisition.

The San Antonio store was doing a volume of $200/sq.ft. partly because of 32% of sales from the supermarket section, and only 15% in soft goods -- which explains why the margins were only 2.8% pre-tax, but the return on equity after tax a respectable 28%.

Assuming the new store did a similar volume and profits, the price paid would be 11% of volume and 8.5 times earnings. The price was 1.8 times invested capital of $1,130,000. If the volume and profits were 50% of those in San Antonio the price would be 15% of revenues and 10 times earnings. Diana was acquiring the land and buildings as part of the acquisition subject to mortgages of $1.6 million.

b. Great Eastern Mills operated 3 discount stores of which the real estate of the 2 large ones is owned:

location	selling area	parking	opened
Route 17, Paramus, N.J.	24,000	600	April 1956
Route 46, Little Falls, N.J.	100,000	2,200	Nov. 1958
Hempstead Turnpike, Elmont, L.I., N.Y.	135,000	2,400	Nov. 1960

The price was 221,000 shares of Diana and $30,000 in cash which had a value of $4.6 million. Great Eastern had sales of about $15* million for the year ending January 31, 1961 which only included a few months for the new Long Island store. For the first half of fiscal 1962 sales were up 130% to about $12 million, and since this did not include the Christmas season, a projection of $25 million would be conservative. Net earnings for this period before taxes were only up 15%, so we used a $200,000 projection, vs. $162,000 earned the previous year. The purchase price was thus some 23 times earnings, 20% of projected gross volume, and 2.2 times invested capital of $2,170,000.

Diana was willing to pay a much higher price for Great Eastern, because while Tex-Marts only leased departments were shoes and liquor, Great Eastern had over half its gross sales from leased departments, and the acquisition price included a 50% interest in the linen departments, a 50% interest in the food department at the new Long Island store, and to quote from page 21 of the November 21, 1961 proxy:

> "The leases for the men's apparel department for the Paramus and Little Falls stores expire in June 1962, and for the Elmont store in October 1963. Diana intends to own and oeprate these departments and accordingly the leases will not be renewed"

* $4,650,000 net sales + $1,024,000 income from leased departments.

	Tex-Mart	Great Eastern Mills
# of stores	2	3
selling area	47,000'	259,000'
price/gross sales	12%	20%
net income	8.5-10x	20-25x
book	1.8x	2.2x

12. Unishops, who at that time was mainly operating 200 leased mens and boys wear departments, acquired the 3 Clarkins discount department stores in the summer of 1966 for 100,000 shares of stock valued at $2.4 million. (listing statement New York Stock Exchange May 20, 1966) 90,000 of the shares were contingent on earnings. The stores had total sales of $21.5 million and net sales of $13.7 million in company operated departments. Pre-tax profits were $530,000 and net income after taxes $300,000. The maximum price/earnings ratio was 8 times. Assets were $2.2 million, there was no debt, and working capital was $470,000. Volume per unit of $7 million was high and pre-tax margins of close to 4% plus a very high return to equity indicated a good operation, and the earnings would hold so that the contingent shares would be issued and the price of over 5 times book value of $370,000 was justified.

The companies preceding Masters in the above table were acquired by other retail chains during this period and the transactions are described on the following page. The companies following Masters in the table are the other operating chains. I have excluded the largest chains since they are not comparable, but have included those operating in the New York area such as Korvette.

A few footnotes are needed. National Bellas Hess operates the GEX membership discount stores which are similar to G.E.S.. In the fiscal years ending in July 1964 and 1965 the chain lost money. The stock steadily dropped from a price of $10 in 1961 and 1962 to $4 in 1964 and 1966, yet it always sold at a premium over book value.

Caldor's earnings in 1966 dropped from $1.6 to $1.2 million, which was temporary and hence we have used historic ratios.

Fed Mart was also having its problems. Earnings for the fiscal year ending August 31, 1966 had dropped 25% but the market must have anticipated a recovery in fiscal 1967 since the stock sold at over 20 times earnings and never under book value.

S. Klein which operated in the same area as Masters (plus Philadelphia and Washington, D.C.) lost money in the fiscal years ending January 31 1965 and 1966, again the stock never sold below book. In fiscal 1967 pre-tax earnings were .6% of revenues -- but the market and Mr. Riklis were willing to pay a premium for the leverage as evidenced by the retail volume controlled with a small market capitalization.

Based on these comparisons and the other factors considered, I would value Masters at $2,200,000, apart from the tax loss carry-forward. This would represent 12% of store revenues and 1.3 times book value and the working capital.

Comparative ratios are on the following table:

Table of Acquisition or Market Prices to:

Company	Revenues	Net Income	Equity Value
Atlantic Mills	16%	11.5x	1.6x
Shoppers World	24	12.	5.5
Disco		15.	8.5
Floyd Bennett	6	def	2.
G.E.S.	9	8.	2.5
Charles	12e		
Ontario	14	8.6	3.
Shoppers City	17	11.5	4.5
Miami Masters	16	def	.8
Town & Country	13	9.	5.
Gulf-Mart	11	9.	1.8
Great Eastern	20	23.	2.2
Clarkins	11	8.	6.5
MASTERS			
Caldor	40	19.	4.
Fed Mart	11	20.	1.
Gaylords	16	7.	1.9
Kings	35	10.	2.
Korvettes	13	12.	1.4
S. Klein	6.5	14.	1.2
Nat Bellas Hess	8.5	9.	1.4
Twin Fair	40	10.	2.
Zayres	25	12.	2.5

As of July 30, 1966 Masters had a tax-loss carryforward of $3.37 million which expired as follows:

1-31-1968	$ 274,045
1969	2,200,045
1970	32,304
1971	72,077
1972	794,815

Based on the projected income of Lady Rose mainly, and to a lesser extent the income from Masters, management anticipated being able to fully utilize this loss. At this time Lady Rose was paying taxes at a 33% rate which was in line with other retailers:

1966 tax rate	
28%	American Snacks
27	Barbara Lynn
32	Diana Stores
33	Daylin
33	Gilbert Shoe
33	Morse Shoe
35	Rockower
40	Mangel
33	Medco
48	Morton Shoe
40	Spencer Shoe
36	Unishops

While the discount department stores were paying a 45% rate on the average, we will use a 35% rate to be conservative. To obtain a present value for this future savings a discount factor of 1.5 times the average 1966 yield on government bonds of 4.66% is used. This would be 7%. We also have taken the conservative assumption that the loss would be used up in the year it expired.

The following valuation is in line with that advocated by John W. Brock, Jr., tax attorney for Westinghouse Electric, writing in the September 1965 issue of Taxes (Volume XLIII, pages 586 ff) and by Allan Ephraim writing in the Winter 1966 edition of Mergers and Acquisitions "How Much Are Tax Losses Really Worth?"

$ 274,045	x 35% =	$ 95,916	x .935	=	$ 90,000
2,200,423	x 35% =	770,148	x .874	=	673,000
32,304	x 35% =	11,306	x .817	=	9,000
72,077	x 35% =	25,227	x .764	=	19,000
794,815	x 35% -	278,185	x .715	=	199,000
					$ 990,000

On January 25, 1967 (the day prior to the shareholder vote on the merger) special tax counsel for Masters was orally advised by the Office of the Commissioner of Internal Revenue that a formal letter would be issued assuring favorable tax treatment of the merger. This coupled with Lady Rose's current earnings and Masters'projected earnings were sufficient to assure that the tax loss carryforward would be utilized, and that the tax rate would probably be well in excess of 35%.

While Lady Rose might not have paid $990,000 in cash for this loss carryforward, it was buying it for stock, and based upon the size of Lady Rose prior to the merger it is unlikely that the Company could have successfully sold stock publicly or even in a private placement. Thus from Lady Rose's point of view they were acquiring between $1.1 and $1.6 million (depending upon whether we use a 33 or 48% tax rate) of future cash which would increase its working capital of $1.8 million by 60 to 90%.

I would value the Masters tax loss carryforward at $800,000.

CONCLUSION.

In November 1966 the pertinent numbers as adjusted per this paper were as follows: (000,000 omitted)

	Masters	Lady Rose
Revenues	$ 18.	$ 13.
Est. pre-tax net	.4	.7
Working Capital	1.8	1.8
Long-term debt	.4	0
Net property	.4	.4
Stockholders Equity	1.7	2.3
+ value of tax-loss carryforward	.8 to 1.3*	-
Adjusted equity	2.5-3.0	2.3
Growth rate	0%	17%
Valuation	$ 3.0	$ 3.35

* using a 48% tax rate

Our analysis shows:

1. It was a buyer's market for leased department operators, and they sold in the market place for a very low valuation based on past growth trends. The highest valuation for these operators was when a landlord (such as Woolco with Kinney and K-Mart with Holly) wanted to expand rapidly and run its own departments but lacked the management expertise in certain areas.

2. The companies that controlled and operated the discount department stores sold at somewhat higher valuations (price-earnings multiples) but more important it was a sellers market for the companies that controlled the stores and hence the revenues. Even unprofitable units could be readily sold to strong lessees who knew the stores since they operated departments in them (i.e. Spencer Shoes, Daylin Drug, Barbara Lynn, and Unishops.)

3. Lady Rose was ready to merge with Masters now that Masters' losses had been stemmed and it had adequate working capital and almost no debt. Lady Rose was protecting 3 of its leases in the Masters stores, and probably would take over other leases in those units as they expired. With the Master's name and combined assets of the new company an expansion program was possible with the leverage inherent as an operator rather than lessee.

4. The Masters' shareholders, if they had been given the pro forma numbers without the losses of the disposed of Miami units, would have felt the stock was now a good speculation: the financial condition was solid; the losses had at least been stemmed; and proven capable retail management with a significant stock interest was now at the helm. Under such conditions one awaits developments rather than selling out -- unless the suitor makes a very attractive proposal.

5. In order to utilize the tax loss carryforward, Masters was to be the surviving company, although for practical purposes we consider Lady Rose the acquiring company.

Thus I conclude that an independent Board of Directors of Masters would not have approved the transaction unless they received a premium over established values. They probably would have insisted on and obtained a 50% interest in the merged companies, which would have been a 10% premium over the valuation shown on the above table. However, to be conservative, I have retained the appraisal of Lady Rose at $3.35 million and Masters at $3 million for purposes of the merger.

Leonard Marx, Jr.

LEVENTRITT LEWITTES & BENDER
ATTORNEYS
CHRYSLER BUILDING
NEW YORK, N. Y. 10017

H. VICTOR LEVENTRITT
(1914-1966)
SIDNEY BENDER
AARON LEWITTES
MICHAEL SCHLESINGER

986-4050
AREA 212
CABLE: BERLEVEN

December 12, 1972

Mr. Leonard Marx, Jr.
415 Madison Avenue
New York, New York

Dear Mr. Marx,

This will confirm the fact that we have retained you, in behalf of the plaintiffs, in Bragalini, et al. v. Biblowitz, et al. pending in the U.S. District Court, Southern District of New York, to prepare and give expert testimony, and to assist us in analyzing expert testimony offered by defendants, as to the fair value of Masters and of Lady Rose securities in connection with the merger of Lady Rose into Masters.

You will be compensated in the event of settlement or judgment conferring a benefit on Masters and/or the minority stockholders. The amount of your fee will be fixed by the Court. We will recommend $75 an hour.

Please signify your acceptance by signing and returning a copy of this letter.

Sincerely,

LEVENTRITT LEWITTES & BENDER

By Sidney Bender

ACCEPTED:

Leonard Marx, Jr.

Leonard Marx, Jr.

EXHIBIT
U. S. DIST. COURT
S. D. OF N. Y.

177 A

MASTERS, INC.

REPORT OF SPECIAL EXAMINATION

THIRTEEN WEEKS ENDED OCTOBER 29, 1966

LAVENTHOL, KREKSTEIN, GRIFFITH & CO.

Certified Public Accountants

LAVENTHOL, KREKSTEIN, GRIFFITH & CO.
(COMBINED WITH LEHER, ABRAMS & CO.)
Certified Public Accountants

178A

444 MADISON AVENUE
NEW YORK, N.Y. 10022

Creditors' Committee
Masters, Inc.

Our examination of the accompanying financial statements for the thirteen weeks ended October 29, 1966 did not include an independent verification of assets and liabilities by direct communication or observation, and is therefore to be considered as unaudited. Accordingly, we are precluded from expressing and do not express an opinion with respect to said statements.

Laventhol, Krekstein Griffith & Co
Certified Public Accountants

January 9, 1967

NEW YORK • PHILADELPHIA • LOS ANGELES • WASHINGTON, D.C. • HARRISBURG • WILKES-BARRE • LEWISTOWN
MEMBER CPA ASSOCIATES / OFFICES IN PRINCIPAL CITIES

MASTERS, I

BALANCE SHEET - OCTO

(UNAUDITE

ASSETS

Current assets:		
Cash	$ 277,205	
Certificates of deposit	62,000	
Accounts receivable:		
Trade	61,289	
Miami sale (Note 6)	203,002	
Vendors	52,055	
Other	28,633	
Merchandise inventories	2,640,868	
Prepaid expenses	72,882	
Insurance claims	59,651	
Total current assets		$3,457,585
Properties, at cost:		
Fixtures, equipment and leaseholds	1,165,893	
Less accumulated depreciation	759,205	406,688
Other assets:		
Due from former officers and others	39,170	
Security deposits	71,989	111,159
		$3,975,432

(a) Includes cumulative loss of $226,656 as defined in the plan of arrangement for period from November 2, 1963 to October 29, 1966 (Refer to Note 1).

Curr
T
Cu
Ac
Du
Cu
Cert
po
Subo
in
Shar
Co
Cr
Su
De

LAVENTHOL, KREKSTEIN, GRIFFITH & CO.

NC.

BER 29, 1966

D)

LIABILITIES AND SHAREHOLDERS' EQUITY

ent liabilities:		
ade payables	$1,493,495	
rrent portion of certificates of indebtedness (Note 2)	315,507	
crued taxes and expenses	235,667	
e to lessees	93,514	
stomers' deposits	14,887	
Total current liabilities		$2,153,070
ificates of indebtedness, less current rtion shown above (Note 2)		24,367
rdinated loan, including accrued terest of $24,055 (Note 4)		307,055
reholders' equity:		
mon stock, $1.00 par, 1,500,000 shares authorized, 512,600 shares issued and outstanding	512,600	
apital in excess of par	683,690	
rplus arising from cancellation of indebtedness	3,084,569	
eficit (a)	(2,7[illegible],583)	
	1,550,276	
Less treasury stock, at cost (Note 7)	80,336	1,4[illegible]9,940
		$3,975,432

MASTERS, INC.

STATEMENT OF INCOME (LOSS) AND DEFICIT
(UNAUDITED)

	Thirteen weeks ended		Thirty-nine weeks ended	
	October 29, 1966 (4 stores)	October 30, 1965 (7 stores)	October 29, 1966	October 30, 1965
Sales, own departments	$2,828,546	$4,795,867	$12,447,450	$14,819,380
Gross profit, own departments	$ 456,373	$ 963,269	$ 2,498,372	$ 3,147,310
Percentage to own sales	16.1%	20.1%	20.1%	21.2%
Rental income, leased departments	119,656	183,953	500,235	557,744
Total gross income	576,029	1,147,222	2,998,607	3,705,054
Operating expenses	745,052	1,303,069	3,319,478	4,188,476
Loss from operations	(169,023)	(155,847)	(320,871)	(483,422)
Other income	7,181	9,811	21,449	30,731
Loss before depreciation and special items	(161,842)	(146,036)	(299,422)	(452,691)
Depreciation and special items:				29,644
Amortization of preopening costs, new stores	(23,704)	(44,895)	(119,887)	(135,997)
Depreciation	4,182	1,290	4,497	1,358
Gain on purchase of creditors' claims (Note 3)			(581,621)	
Loss on termination of Miami operations (Note 6)	(20,254)			
Net loss	($ 201,618)	($ 189,641)	(996,433)	($ 558,525)
Deficit, beginning			(1,709,150)	
Deficit, end			($ 2,705,583)	

MASTERS, INC.

NOTES TO FINANCIAL STATEMENTS

OCTOBER 29, 1966

(UNAUDITED)

1. Cumulative operating loss

Under the terms of the confirmed plan of arrangement, in the event that cumulative operating losses subsequent to November 1, 1963 exceed $400,000 (before depreciation and special items), the debtors are required to accelerate the unpaid installment balances payable to the unsecured creditors. The cumulative operating loss incurred from November 2, 1963 to October 29, 1966 totals $226,656 (refer to supplementary information, page 8).

2. Payments under plan of arrangement

Under the confirmed plan of arrangement, the company is required to make 45 monthly installment payments of two-thirds of one percent each with respect to claims of unsecured general creditors. The payments are due monthly from February 1964 to October 1967. In compliance with the terms of the plan, the company is continuing to make the required monthly installment payments. The amounts paid during the period from March 25, 1964 to December 27, 1966 total $1,021,490.

As at October 29, 1966, installment obligations of $339,784 remain to be paid of which $315,507 is due within one year and $24,367 is due subsequently. During the period from October 30, 1966 to January 9, 1967 the company made payments totaling $138,334 (including a prepayment of $100,000) and purchased certain creditors' claims with remaining balances of $51,502 (see note 3 below).

3. Purchase of creditors' claims

The books of the company indicate that the balances payable on certain creditors' claims have been purchased by the company at discounted amounts as follows:

	Unpaid balance of claim	Amounts paid	Gain on purchase
Period ended May 2, 1964	$ 17,130.17	$ 8,956.40	$ 8,173.77
Fiscal year ended May 1, 1965	236,938.27	126,920.56	110,017.71
Fiscal period ended January 29, 1966	4,527.25	2,789.75	1,737.50
Thirty-nine weeks ended October 29, 1966	21,540.63	17,043.50	4,497.13
Period from October 30, 1966 to January 9, 1967	51,502.64	41,220.87	10,281.77
	$331,638.96	$196,931.08	$134,707.88

MASTERS, INC.

NOTES TO FINANCIAL STATEMENTS

OCTOBER 31, 1966
(UNAUDITED)

4. Subordinated long-term debt

a) Subordinated long-term debt is comprised of the following:

9% loan due December 27, 1969	$283,000
Accrued interest	24,055
	$307,055

The 9% subordinated loan was obtained in compliance with the terms of the court approved plan of arrangement. Interest on this loan, at the rate of 6% per annum, is payable in current semi-annual installments. The balance of 3% is postponed until the deferred payments required by the plan have been completed. Options to convert these loans into common stock of the company have been granted to the loan holders. The lenders may purchase three shares of the $1.00 par value common stock for each dollar of loan at the rate of $1.25 per share to December 27, 1966 and $2.00 per share to December 27, 1968.

b) Series A debentures in the amount of $250,000, formerly subordinated, were redeemed by the company on July 26, 1966 for $225,000 out of the proceeds realized from the sale of assets located in Miami, Florida. In addition, the company also redeemed $182,000 of formerly subordinated Series B debentures at face value on August 1, 1966. These redemptions have been approved by the creditors' committee.

5. Restricted stock options

On June 3, 1963, the Board of Directors of Masters, Inc. approved a restricted stock option plan for officers and key employees. Pursuant to this plan, options to purchase 56,000 shares of common stock at ten cents (10¢) per share (representing not less than 100% of the market value at the date of grant) were authorized. As at October 29, 1966, the options for 45,200 of these shares have been exercised by officers of the company and options for 7,200 shares were cancelled due to the resignation of Mr. Jack Haizen as president of the company (see note 7).

The options with respect to the remaining 3,600 shares may be exercised in equal installments on or after December 3, 1966 and 1967. All unexercised options expire on June 3, 1968.

183 A

MASTERS, INC.

NOTES TO FINANCIAL STATEMENTS

OCTOBER 29, 1966
(UNAUDITED)

6. Loss on termination of Miami operations

As at July 26, 1966, the company terminated the operations of its three store sites in the Miami, Florida area and sold its tangible assets to Zayre of Florida, Inc. and Zayre Leasing Corporation for $1,897,816. This transaction resulted in a loss to the company of $581,621. To the date of this report, $1,697,816 has been received from the purchasers. The remainder of $200,000 is due on January 25, 1967 with interest at the rate of 5 3/4% per annum. The aforementioned bulk sale was approved by the creditors' committee.

7. Resignation of president

On September 6, 1966, Mr. Jack Haizen resigned as president of the company. The company also purchased 44,638 shares of capital stock from Mr. Haizen for $89,336.

LAVENTHOL, KREKSTEIN, GRIFFITH & CO.

MASTERS, INC.

CUMULATIVE LOSS UNDER PLAN OF ARRANGEMENT
(UNAUDITED)

The cumulative loss to October 29, 1966, before depreciation and special items excludable under the stop-loss provisions of the confirmed plan of arrangement, is $226,656 as follows:

Income - period from November 2, 1963 to January 29, 1966	$ 72,766
Loss - thirty-nine weeks ended October 29, 1966	(299,422)
Net cumulative loss	($226,656)

MASTERS, INC.

FINANCIAL CONDITION
(UNAUDITED)

In order to indicate the changes which have occurred in the financial structure of the company for the thirteen week period ended October 29, 1966, the following summary is presented:

	October 29, 1966	July 30, 1966	Increase (Decrease)
Current assets	$3,457,585	$4,534,071	($1,076,486)
Current liabilities	2,153,070	2,835,858	(682,788)
Working capital	1,304,515	1,698,213	(393,698)
Fixed and other assets	517,847	498,658	19,189
	1,822,362	2,196,871	($ 374,509)
Long-term debt	331,422	415,697	(84,275)
Shareholders' equity	$1,490,940	$1,781,174	($ 290,234)
Current ratio	1.6 to 1	1.6 to 1	

The decrease of $290,234 in shareholders' equity during the thirteen week period ended October 29, 1966 is due to the following:

Net loss for period	$201,618
Acquisition of capital stock from Mr. Jack Haizen	89,336
Proceeds from exercise of restricted stock options	(720)
	$290,234

MASTERS, INC.

CHANGES IN WORKING CAPITAL
(UNAUDITED)

The decrease of $393,698 in working capital is attributable to the following factors:

Application of working capital:			
Net loss for period	$201,618		
Depreciation included	23,704	$177,914	
Reduction in non-current certificates of deposit		86,397	
Acquisition of capital stock from Mr. Jack Haizen		89,336	
Increase in security deposits		22,283	
Additions to fixtures, equipment and leaseholds		21,880	$397,810
Sources of working capital:			
Increase in non-current interest on subordinated debt		2,122	
Repayment of employee loans		1,270	
Proceeds from exercise of restricted stock options		720	4,112
Decrease in working capital during period			$393,698

MASTERS, INC.

COMPARISON OF BOOK AND PHYSICAL INVENTORIES
(UNAUDITED)

A physical count of inventory was made by the company as at October 29, 1966 at all metropolitan area stores, which resulted in an unexplained inventory shrinkage as follows:

Computed book inventories (at retail value)	$4,055,838
Physical inventories (at retail value)	3,545,306
Inventory shrinkage (at retail value)	510,532
Normal shrinkage factor charged to operations during the thirty-nine weeks ended October 29, 1966	352,140
Unexplained shrinkage at retail	$ 158,392
Unexplained shrinkage at converted cost	$ 118,097

With respect to the aforementioned unexplained shrinkage which would include unrecorded markdowns, if any, the following percentage relationships should be noted:

Metropolitan area sales for nine months ended October 29, 1966		$8,972,504
		Percentage to metropolitan area sales
Inventory shrinkage (at retail value)	$510,532	5.7%
Normal shrinkage applied to operations	352,140	3.9
Unexplained shrinkage (at retail value)	$158,392	1.8%

The unexplained shrinkage is reflected in the results of operations for the thirteen weeks ended October 29, 1966. The gross profit percentage for the period, before inclusion of the unexplained shrinkage, is computed as follows:

Gross profit for period (refer to page 3)	$456,373
Add unexplained inventory shrinkage at converted cost (above)	118,097
Gross profit for period, before unexplained inventory shrinkage	$574,470
Gross profit percentage, before unexplained inventory shrinkage	20.3%

issue with the decision. Certainly one can draw from this that IRS is discouraged about prevailing in cases where the internal allocation of costs and tariffs in a business needs to be precisely determined.

Purchase of an inactive corporation. Take the case of a tax loss corporation (that has not been *corporately* inactive) that had been carrying on a trade or business just prior to a change in its ownership. If the new owners sometime later reactivate the same line of business as that originally conducted, has the "same trade or business" been continued, so that the loss may be carried over to the new owners? The IRS position in its regulations is that the same trade or business *has not been continued* unless it can be demonstrated that the activities were *temporarily* discontinued at the time of transfer. At least two recent court cases upheld this position. However, the same position was repudiated in a recent tax court case, *Barclay Jewelry Inc. (TC Memo 1965-265).*

Barclay Jewelry had been purchased by a new group in 1958. It remained relatively inactive *operationally* until 1960. At that time its new owners, having expanded the line of a related company, and wishing to sell this line to some of the former customers of Barclay, reactivated Barclay *operationally.*

The Commissioner attempted to disallow the net operating loss deduction claimed for years prior to 1958, on the grounds that Barclay Jewelry had not continued to carry on its trade or business substantially the same as it had before the change in ownership. The court, however, differed with IRS after hearing evidence that the corporation's charter had not been surrendered; that money had been loaned it for indirect expenses during its inactive years, and that it had filed income tax returns for 1958 and 1959. It held that there *was* a continuity of business as required by the code. Accordingly the net operating loss deduction *was* allowed.

A disproportionate purchase price

A caveat must be inserted here. There is a presumption in section 269 that if the amount paid or exchanged for the tax loss corporation is substantially disproportionate to the adjusted basis of the property received *without* the tax loss, this fact shall be *prima facie* evidence that the principal purpose of the acquisition was tax avoidance. Therefore the acquisition of a corporation whose only "asset" is its tax loss will surely run aground on the reef of section 269. But again, with prices of stocks (even without earnings) so greatly differing from the book or net asset values, who's to say what an "asset" is?

Evaluating a tax loss deduction

Assume, for example, you wish to acquire a corporation with a tax loss of $1,100,000. You might think the tax loss is worth $528,000 (48 percent of $1,100,000), but this just is not so. Assume the loss expires $200,000 in 1966, $100,000 in 1967, $200,000 in 1968, $300,000 in 1969, and $300,000 in 1970 and that you estimate your chances of generating that much profit in each of those years are 100 percent, 80 percent, 60 percent, 50 percent, and 50 percent respectively. Assume further that your attorney estimates you have a 50 percent chance of winning the case if you are challenged and that legal fees will be $52,000.

In this case the tax loss is worth no more than $118,983.96. This is computed below.

Utilizing a corporation's tax loss by NOT purchasing the corporation.

An interesting scheme whereby a builder and a banker utilized a tax loss of a hardware corporation without purchasing it and without continuing its losing business has gained court approval in the Ninth Judicial Circuit

	1966	1967	1968	1969	1970
Last year for using loss	200,000	100,000	200,000	300,000	300,000
Tax rate	.48	.48	.48	.48	.48
	96,000	48,000	96,000	144,000	144,000
Surtax differential	6,500	6,500	6,500	6,500	6,500
Tax	89,500	41,500	89,500	137,500	137,500
Estimated legal expenses	5,000	7,000	15,000	15,000	10,000
Net after legal expenses	84,500	34,500	74,500	122,500	127,500
	.50	.50	.50	.50	.50
Amount after reduction to reflect a 50% probability of winning the court case.	42,250	17,250	37,250	61,250	63,750
Profit probability	1.	.8	.6	.5	.5
Gross value of tax loss	42,250	13,800	22,350	30,625	31,875
Present value of tax loss for 1 through 5 years discounted at 6% per year	39,858.65	12,282.00	18,765.06	24,258.06	23,820.19
PRESENT VALUE OF TAX LOSS					118,983.96

DX AB

DX AQ

COMPARISON OF MASTERS & LADY ROSE AT 7/30 and 8/31/66

	Current Assets	Current Liabilities	Working Capital	Ratio	Net Worth	Retained Earnings
Masters	4,574,511	2,835,858	1,738,653	1.613	1,781,174	580,604
Lady Rose	3,571,506	1,750,436	1,821,070	2.04	2,532,200	2,312,125

MASTERS, INC.

Date	Current Assets	Current Liabilities	Working Capital	Ratio	Net Worth	Retained Earnings
April 30, '63	5,115,974	6,182,247				
May 2, '64	4,801,132	1,722,976	3,078,156	2.787	2,564,690	1,367,920
May 1, '65	6,359,956	3,673,638	2,686,318	1.731	2,646,802	1,447,132
39 weeks: Jan. 29, '66	4,947,674	2,536,036	2,411,638	1.969	2,575,989	1,375,419
July 30, '66	4,574,511	2,835,858	1,738,653	1.61	1,781,174	580,604
Jan. 28, '67	2,648,033	1,479,146	1,168,887	1.789	1,329,313	217,179

LADY ROSE, INC.

Date	Current Assets	Current Liabilities	Working Capital	Ratio	Net Worth	Retained Earnings
2/29/64	1,736,887	901,186	835,701	1.92	1,447,469	1,227,394
2/28/65	2,277,850	1,197,193	1,080,657	1.90	1,748,732	1,528,657
2/28/66	2,982,149	1,518,593	1,463,556	1.96	2,200,709	1,980,634
8/31/66	3,571,506	1,750,436	1,821,070	2.04	2,532,200	2,312,125
3/1/66-1/28/67	3,479,769	1,492,400	1,987,369	2.33	2,718,669	2,508,082

Dx AZ

OPINION OF MARTIN J. WHITMAN RE MERGER OF LADY ROSE STORES, INC. INTO MASTERS, INC.

In my opinion, the merger of Lady Rose Stores, Inc. (Lady Rose) into Masters, Inc. (Masters) was on terms which were fair and equitable to the Masters stockholders. Further, the merger was highly beneficial to Masters.

In arriving at my conclusion, I considered a number of factors including the financial and business histories of both corporations; their financial positions and management situations; the potential of the merged enterprise and an evaluation of the benefits and encumbrances, whether tangible or intangible, which each would bring to the merged enterprise.

Materials reviewed by me included various exhibits pertinent to the merger including the Masters Proxy Statement dated December 22, 1966, various long form financials of Lady Rose and Masters, minutes of certain Masters board meetings and various memoranda and applications. I also examined a draft copy of the Joint Pre-Trial Memorandum in the matter of Bragalini v. Biblowitz dated December, 1971. Other data read included accounting sources such as APB Accounting Principles published by the American Institute of Certified Public Accountants and Accounting Trends and Techniques. I also referred to standard stock market sources such as newspaper indices, Securities and Exchange Commission (SEC) publications,

brokerage house write-ups, Standard & Poor's, Moody's and The Bank and Quotation Record. In addition, I have, from time to time, met with, or interviewed, various people in connection with this matter including attorneys, tax advisers, investment bankers, accountants and industry sources.

In my opinion, a fair and reasonable value for the Lady Rose equity would be in a range between $5 - $6 million based on a price earnings ratio of approximately 8 to 10 times conservatively estimated earning power at that time of approximately $600,000 per annum.

Plaintiffs' apparent allegations in the Joint Pre-Trial Memorandum that a $600,000 earnings estimate for the fiscal year to end February 1967 was anything but conservative (see especially Paragraph 35(J)) are erroneous for the following reasons:

(a) The Lady Rose tax rate of thirty-two per cent (32%) was proper and posed no special jeopardy of a special charge by the Internal Revenue Service (IRS). Virtually all businesses similarly situated took advantage of the surtax exemption available to multiple corporations. While the effective income tax rate, both federal and state, exceeded fifty per cent (50%) in fiscal 1966, the over-all income tax rate was only 39.1% for all companies with profitable

records which filed Annual Reports with the SEC; which were further identified by the SEC as Retail Trade-Apparel and Accessories Stores, Except Shoes, and for which financial data were carried in the December 1966 Standard & Poor's Stock Guide. Six of these companies had fiscal 1966 tax rates below thirty per cent (30%). Few, if any, would have had their tax returns audited by IRS for the most recent two or three years. None, in their accounts, had reserves for highly speculative possible tax liabilities. Indeed, it would have been in violation of Generally Accepted Accounting Principles (GAAP) for Lady Rose, or the others, to have earmarked reserves for such unknown, vaguely possible tax liabilities.

(b) Lady Rose did, in fact, take into account discontinued operations, as well as the possibility of adversities, in making a $600,000 estimate for the year to end February 28, 1967. Normally, the months of November and December are the "big months" in retailing, accounting for a disproportionate part of an operator's annual earnings. For example, for the year ended February 28, 1966, Lady Rose reported net income of $451,977 after having reported net income of $166,701 in the first six months of that fiscal year. Thus, earnings during the second half of that fiscal

year accounted for 63.1% of Lady Rose's profits for the entire year ended February 28, 1966. In contrast, an earnings estimate of $600,000 assumed that only 44.8% of the annual earnings would have been earned in the second half of the year to end February 28, 1967. Lady Rose had already reported net profits of $331,491 for the six months ended August 31, 1966. If the Lady Rose estimate had been based on the same seasonal pattern that had prevailed the year before, estimated earnings for the year to end February 28, 1967 would have been $898,000, not $600,000.

(c) In valuing a business, earning power -- i.e., the ability to be profitable in the future is more important than reported earnings -- i.e., a record of what had happened historically. In fact, reported earnings are important primarily insofar as they are an indicator of earning power. Plaintiffs, by implication, seem to have had a strong belief that Lady Rose's basic earning power probably was well in excess of $600,000 per annum because if it was not, there would be little or no practical prospect of the merged enterprise being able to utilize effectively the available tax loss carryforward. Plaintiffs attribute a value to the tax loss carryforward without dis-

count in the belief that there would be enough earnings so that the loss carryforward could be used. Unusable tax loss carryforwards have virtually no value.

Every type of business has advantages and disadvantages. One advantage retail concessionaires have over retail landlords is the concessionaires' flexibility. Concessionaires' investment in locations are small and easily terminable. Thus, Lady Rose's investment in a typical location would be about $100,000 for inventory and $50,000 for fixturing while Masters, as a landlord, might, in contrast, have to invest well over $1 million in inventory and fixturing to go into a moderate-sized new location. In addition, Masters would have to enter into a long term lease or mortgage arrangement. Lady Rose's ability to take advantage of other landlord opportunities was limited by the "stretchability" of its management and supervisory resources. In any event, Lady Rose's concessions in Masters were replaceable. On the other hand, Masters would have had difficulty without the merger in either attracting good concessionaires or qualified personnel to run departments in light of its checkered record, poor credit standing and limited physical facilities. A good department -- whether leased or operated -- gives benefits to Masters, or any retail operator, over and above the

payment of rent, or the reported profits per square foot, or return of dollars invested. Well-run departments draw traffic and enhance the image of an entire operation. (The opposite is, of course, true for poorly run departments.)

Masters, as a landlord, was becoming less and less important to Lady Rose from fiscal 1962 (year ended February 28, 1963) through fiscal 1966. During this period, Lady Rose's profitability was increasing significantly. One piece of evidence of the replaceability of Masters as a Lady Rose landlord lies in the fact that the Messrs. Biblowitz were prime movers in closing Masters' Florida operations (which operation had largely been sponsored in Masters by Jack Haizen) even though that particular business had accounted for an increasing proportion of Lady Rose's net income during the period. The following table reviews pertinent Lady Rose data from fiscal 1962 through fiscal 1967. It shows (1) a rising trend for Lady Rose sales and earnings, (2) Masters' ex Florida counting for a continually decreasing proportion of Lady Rose's sales and net income, and (3) Masters' Florida accounting for an increasing portion of Lady Rose's sales and net income until sold.

LADY ROSE, INC.
PEP CENT OF OVER-ALL SALES AND NET INCOME

Year Ended	(000) Sales	Net Income	Operations in Masters Ex Florida Sales	Net Income	Operations in Florida Sales	Net Income
1/28/67*	$13,182	$527	14.2%	15.9%	5.0% (B)	8.9% (B)
2/28/66	13,125	452	16.0	17.5	14.0	14.2
2/28/65	11,194	301	19.9	22.6	11.2	9.0
2/29/64	8,177	205	21.3	29.3	7.4	3.9
2/28/63 (A)	7,381	229	32.5	35.4	4.1	2.2

(A) Audit Certificate Qualified.
(B) Masters Florida was sold 7/30/66.
* Eleven Months.

In my opinion, the fair value of 391,103 Masters common at the time of the merger was not more than $500,000. 391,103 Masters common represents all the outstanding equity of Masters not owned by the Biblowitzes who, through Lady Rose, held 69,629-17/27 Masters common shares.

At the time of the merger, Masters was in need of a rescue operation. Its credit standing was poor, its management situation was uncertain, and it was reporting losses. There was no indication that its four-store Metropolitan New York operation (Metropolitan Masters), the only remaining operation, could be made viable. Two of the four stores, 48th Street and Flushing, were consistent deficit operations; one, Lake Success, had an in and out record; and only one, Elmsford, was generally (but not always) profitable.

Further compounding the difficulties to obtain earning power for Metropolitan Masters was the sale in July 1966 of Masters' Florida operations. The Florida operations had absorbed a portion of Masters' central overhead which included expense items such as buying, bookkeeping and home office administration.

To obtain earning power, it was important for Metropolitan Masters to expand so that central overhead could be spread over more operations. For example, the 22,913 square foot 48th Street store, the only one in the Manhattan-Bronx area, had no advertising umbrella. As a matter of fact, Metropolitan Masters did lose \$360,000 in the year ended January 28, 1967 and an additional \$39,779 in the first year after the merger. Yet, Masters did not have enough credit standing to be able to negotiate reasonable leases with real estate landlords and to finance inventory, nor was in it in a position to attract able operating management and/or new concessionaires.

Based on the test of a meaningful market place, the value of Masters common at the time of the merger was less than \$1.25 per share, or something under \$489,000 for 391,103 shares. Furthermore, such a value of under \$1.25 per share is based on Masters having a better financial position than was actually the case since such a price

would be based on informed investors investing new funds into Masters rather than buying already outstanding stock from existing shareholders.

Each of the purchasers of the $283,000 subordinated loan had the right until December 27, 1966, to purchase Masters common at $1.25 per share. These people could have purchased an aggregate of 849,000 Masters common at $1.25 per share payable in the aggregate by the surrender of the $283,000 subordinated notes to be valued at par, plus accrued interest, and the payment to Masters of a maximum of $778,000 cash assuming there was no accrued interest. After December 27, 1966, the exercise ~~power~~ price was stepped up by sixty per cent (60%) from $1.25 to $2.00. Thus, if an investor attributed a value of more than $1.25 (in subordinated notes and cash) to Masters common, he would, in the economic sense, have "been forced" to exercise before December 27, 1966.

The fact is that virtually all these investors -- who would have accounted for sixty-one per cent (61%) of the combined Masters common capitalization if they exercised their warrants (seventy-one per cent (71%) including the Biblowitzes holdings) -- voluntarily surrendered their warrants. It is difficult to perceive why they would not have exercised had the value of Masters exceeded $1.25 per share.

If Masters were worth more than $1.25 per share, then the 391,101 shares can be assumed to have only a twenty-nine per cent (29%) interest in Masters; and per share net asset value at July 30, 1966 adjusted for the exercise of warrants would be ~~twenty~~ forty-four per cent (~~24%~~ 44%), less than the reported per share net asset value, unadjusted for the exercise of warrants.

On June 3, 1963, Masters granted restricted stock options to officers and key employees to purchase 56,000 common shares at $.10 per share, $.10 per share was stated as "representing not less than one hundred per cent (100%) of the market value at the date of grant." Despite the fact that there may be questions as to how much progress Masters had made as a business from mid-1963 to the date of the merger, it is unrealistic to consider the $.10 a share as a market value. Rather, it is in the nature of a "tie-in" sale, something designed to give management incentive. By the same token, certain other figures also do not represent a true market value, or fair value -- e.g., the $2.00 per share paid as part of the termination agreement between Jack Haizen and Masters; and the figure of $2.2 million used for New York State franchise tax purposes, as of January 28, 1967, when it was stated that "the average fair market value (of Lady Rose consolidated) was -- $2,196,075.78" (Paragraph 33 of Joint Pre-Trial Memorandum). Such figure was based on

book figures, not value figures and book figures are commonly used by New York corporations in preparing franchise tax returns.

The Masters tax loss carryforward was fully accounted for and paid for under the terms of the merger. Plaintiffs appear, from the Joint Pre-Trial Memorandum, to have no appreciation of the factors involved in utilizing, and valuing, a tax loss carryforward. Whatever the gross cash value of the tax loss carryforward was, say, fifty per cent (50%) of face amount, it has to be reduced by the following:

(a) Since the Masters tax loss was "company only" and not "consolidated return", Lady Rose had to merge with Masters in order to use the tax loss as an offset to Lady Rose's earnings. By merging, Lady Rose assumed all of Masters' obligations without insulation, including, inter alia, special obligations to the creditors committee. Had Lady Rose not wanted to both utilize the tax loss carryforward and directly commit its credit standing to Masters, Lady Rose, if it still desired to amalgamate with Masters at all (which seems doubtful), would have done so in a form that would have insulated Lady Rose from Masters' problems. That is, the amalgamation would not have been in the form of

a merger with its attendant problems, but, rather, on the basis of parent-subsidiary, or holding company -- two subsidiaries, or purchase of assets. In valuing Masters' tax loss carryforward, a large part of its value has to be netted against a price Lady Rose paid, in terms of putting at risk a well-financed business, profitable since 1925, in a transaction where Lady Rose became subject to all known present, unknown contingent, and possible future problems of the Masters' operations and had to do so in order to utilize the tax loss carryforward.

(b) Lady Rose brought improved financial position and credit standing to Masters at a time when it was crucially needed.

(c) Lady Rose's effective tax rate was only around thirty-two per cent (32%) because it did not file consolidated returns. It would not have been subject to a fifty per cent (50%) tax rate if it did not merge with Masters. Therefore, the tax loss carryforward could not be worth to Lady Rose as much as fifty per cent (50%) of its face amount based on this fact alone.

(d) The merged company would not realize tax savings in cash immediately, but only at best over

several years. Value of cash savings should be discounted to a present value.

(e) In order to utilize the tax loss carryforward, earnings had to be achieved relatively rapidly in a situation fraught with uncertainties (e.g., all four surviving Masters stores suffered operating losses in the fiscal year ended January 28, 1967 and the aggregate operating loss was $360,000 based on audited figures). Almost $2.5 million of the loss was due to expire within two years. There was nothing in the historic pattern of net income to suggest such results might be even remotely achievable. Page FS-17 of the Proxy Statement shows pro-forma combined summary of net income as follows:

Fiscal Year	(000) Profit or (Loss)*
1963	($688)
1964	252
1965	505
1966	420

*Before Special items and before taxes.

(f) The merged company was still left with a Section 269 problem after using the tax loss carryforward or any portion thereof, i.e., IRS could still contest its usability in whole or in part. Value of possible future cash savings should be discounted to reflect this.

(g) Insofar as Lady Rose had plans to go public, the value of the tax loss carryforward was limited by the fact that its use would not result in recurring net income for financial reporting purposes. Rather, it gave the merged enterprise cash flow it would not otherwise have plus extraordinary income for financial reporting purposes. Therefore, cash generated from use of carryforward tends to be worth considerably less in public stock markets than cash generated from operations.

(h) Masters' tax return had only been reviewed through April 30, 1963 and size of tax loss could be only an estimate. Value should be adjusted for this uncertainty.

(i) Lady Rose would, in effect, have to finance Masters' future losses (which did, in fact, occur).

Masters' trade name was only of limited value, at best, especially since it had negative connotations among many suppliers, real estate landlords and other creditors. Further, the retention of the Masters name after the merger was not wholly voluntary since, retaining the same business name avoided potential problems under Section 269 of the Internal Revenue Code as to the utilization of the tax loss carryforwards that had been created when prior deficit operations had been conducted under the Masters name.

Plaintiffs imply in the Joint Pre-Trial Memorandum that Masters' assets depreciated only in the tax and accounting senses, not in the economic sense. While, for certain types of assets (e.g., office buildings), depreciation charges for tax (and, frequently, book) purposes may exceed actual economic depreciation, if anything, the opposite was true in Masters' case. For Masters' depreciation is just as much an expense as reserve for doubtful accounts, or any other reserve where there is economic cost and the accounting theory for charging income is the same. In closing a total of eight stores between fiscal 1962 and fiscal 1966, Masters disposed of considerable amounts of depreciable assets in the form of store fixtures and equipment and improvements to leaseholds. If the assets were, in fact, worth more than their depreciated cost, Masters would have realized profits reflected either as credits to operations or special items. Generally, Masters sustained considerable losses compared with depreciated cost on the disposal of fixed assets. Masters' depreciation policies for depreciable assets was not particularly conservative (Lady Rose's may have been) in that write-offs were generally on a straight line basis over a ten-year period.

The Masters Proxy Statement dated December 22, 1966, omitted certain factors unfavorable to Masters and favorable to Lady Rose, for example:

(a) Masters was short of credit and could not negotiate for new locations or reasonably expect to attract top flight management and concessionaires.

(b) Masters was in the midst of a chaotic management situation without any day-to-day operating head.

(c) Lady Rose and its predecessor had been successful since 1925.

In my opinion, the accounting judgments were sound which resulted in the financial statements in the Proxy Statement not being pro-forma-ed to reflect the elimination of the prior operations of Masters Florida.

(a) Opening and closing operations at various locations were continually recurring matters for both Lady Rose and Masters. Since such events were recurring, it, for example, might be misleading to adjust Lady Rose's accounts to reflect Florida closings and make no offsetting allowance for the likely profits from the large amount of funds Lady Rose had earmarked for new openings at the time of the merger.

(b) The exclusion of Masters Florida could be misleading at that time because its exclusion would take no account of the fact that Masters Florida, outside its own profit and loss figures, contributed to the central overhead referred to hereinbefore.

(c) Other independent accountants, in the analagous situation, did not separate out Masters Florida. Laventhol, Krekstein, Griffith & Co., in its report to the Masters' Creditor Committee for the year ended January 28, 1967, did not separate out the discontinued Masters Florida operation.

(d) GAAP, at that time, seemed to encourage not separating out Masters Florida operation. Such viewpoints are reflected in Accounting Principles Requirements for the use of judgment; in the accounting treatment used by other companies to reflect discontinued operations as reported in Accounting Trends and Techniques; and, insofar as examples used in Opinion 9 of the Accounting Principles Board published December 1966 was concerned, there clearly was no requirement to restate operations to eliminate discontinued operations in those instances where starting operations and discontinuing operations were generally recurring activities for a company.

PX 15

209A

KALISH, RUBINROIT & CO.
CERTIFIED PUBLIC ACCOUNTANTS
165 BROADWAY
NEW YORK, N. Y. 10006
BARCLAY 7-7866

21 12
11/17/70

PERSONAL AND CONFIDENTIAL — May 23, 1966

Messrs. Louis, Max and Jess Biblowitz
Lady Rose Stores, Inc.
2400 Marcus Avenue
New Hyde Park, N. Y.

Dear Lou, Mac and Jess:

The enclosed confidential memorandum exhibits and discusses the accounting and tax aspects of a plan of merger of Lady Rose Stores, Inc. and Masters, Inc.

At this writing, the plan is presented without comment or opinion of this office and is intended to be informative only.

I shall be pleased to discuss with you in detail any questions that may arise from your study of this plan as well as the many other considerations that arise before a plan of this type may be undertaken.

Cordially,

Bernard Mintz

BM:ao
Enc.

Confidential memorandum re:

PROPOSAL OF PLAN OF MERGER LADY ROSE STORES, INC. AND MASTERS, INC.

Submitted below is a proposed plan of merger between Lady Rose Stores, Inc. and Masters, Inc. This plan of statutory merger is intended to qualify as a tax-free exchange within the meaning of Sec. 368 (a)(1)(A), IRC, 1954. Lady Rose Stores, Inc. is the acquiring corporation and survives the merger.

Under the plan, 2 shares of Masters, Inc. stock will be exchanged for 1 share of Lady Rose Stores, Inc. and 1 share of Lady Rose Stores, Inc. stock is exchanged for each $5 of 9% subordinated loan (total outstanding $280,000).

The shareholders of Lady Rose thereby acquire 79.68% of the combined equities of the merged companies.

The shareholders of Masters, Inc. acquire the balancing minority interest of 20.32%.

Because the plan is a tax-free reorganization, the net operating loss carry-forward of Masters, Inc. of $2,579,000 at January 31, 1966 becomes available to the surviving company after the merger <u>in full</u> until the expiration dates as follows:

1968	$ 274,800
1969	2,199,700
1970	32,500
1971	72,000
	$2,579,000

(Sec. 381, IRC, 1954).

An important tax aspect of this plan is the availability of the carry-over loss without the reduction described in Sec. 382(b) because the stockholders of Masters, Inc. (the loss corporation) retain at least 20% of the stock of the acquiring corporation. Under the law, (Sec. 382 (b)) a reduction in the carry-forward loss of 5% is required for each 1% of equity below 20% not retained by the stockholders of the loss corporation in the surviving corporation. (Example - if the loss corporation stockholders retain only 10% in the merged company, then only 50% of the loss carry-over is available).

The proposal is based on the financial data following:

	Lady Rose Stores, Inc.	Masters, Inc.
Net worth	$2,300,000	$2,575,000
9% subordinated loan	-	280,000
Net income	$500,000	None
Shares outstanding	1,000.000*	500,000
*Pro-forma		
Book value per share	$2.30	$5.15
Earnings per share	$.50	None
Valuation for this proposal	(1) $5,000,000	(2) $1,250,000
Valuation per share	$5.00	$2.50
(1) (10 x earnings)		
(2) $2.50 per share		

Exchange offering: 1 share of Lady Rose stores, Inc. for 2 shares of Masters, Inc.
1 share of Lady Rose Stores, Inc. for each $5 of 9% - subordinated loan.

The following pro-forma financial data gives effect to the proposed merger plan:

Net worth - (pro forma)

Shares		Net worth
1,000,000	(Lady Rose Stores presently outstanding)	$2,300,000
250,000	(To be issued to Masters, Inc. stockholders	2,575,000
56,000	(To be issued to Masters 9% subordinated loanholders)	280,000
1,306,000		5,155,000
(35,000)	(Lady Rose stock relating to 70,000 Masters, Inc. shares presently owned - to be retired	(80,000)
(16,000)	(Lady Rose stock relating to $80,000, 9% subordinated loan presently owned-to be retired	(80,000)
1,255,000	Total outstanding	$4,995,000

Book value per share = $3.98

Equity of Biblowitz family - $\frac{1,000,000}{1,255,000}$ = 79.68%

or 79.68% of $4,995,000 = $3,980,016

Net income (pro-forma)

Net income (before provision for federal income taxes)	(1) $800,000
(1) Based upon Lady Rose Stores operations for year ended February 28, 1966 and assuming no profit or loss on Masters operation.	
Provision for federal income tax	(2) None
(2) On the basis of projected continued earnings of $800,000, all but $75,000 of the carryover loss of $2,579,000 will be utilized before expiration dates.	
Net income per share	$.64
Equity of Biblowitz family in net income 79.68% x $800,000	$637,400

Summary

A comparison of pertinent financial data as it pertains to the Biblowitz family is exhibited before and after merger.

	Before merger		After merger
Equity in net worth	$2,300,000		$3,980,016
Per share	$2.30		$3.98
Equity in net income	500,000	(1)	637,400
Per share	$.50		$.64
Stock ownership	100%		79.68%

(1) Based upon utilization of loss carry-forward, and upon assumption that no profit or loss is sustained in Masters operation.

Copy Rec'd May 8, 1974
Clues Schenck & Schwartz
attys for Masters Inc

Copy RECEIVED
1974 MAY -8 AM 11:01
SHEA, GOULD, CLIMENKO & KRAMER
ATT. TO Defendants-Appellees